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OVERSIGHT HEARING ON MERGERS

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

EFFECTIVE ANTITRUST ENFORCEMENT

MARCH 11, 1987

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OVERSIGHT HEARING ON MERGERS

WEDNESDAY, MARCH 11, 1987

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS
OF THE COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met at 9:50 a.m., pursuant to notice, in room SR-385, Russell Senate Office Building, Hon. Howard Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Heflin, Thurmond, and Humphrey.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. Good morning. The subcommittee will come to order.

The subject of this hearing is mergers, in particular whether this administration has done a good job of enforcing the law prohibiting mergers which harm competition. In my view, the record is clear: The Reagan administration has created the most permissive merger climate of the last seventy years. It claims to be a substantial major proponent and supporter of the free enterprise system. It claims to be for free competition.

Yet it has turned its back on antitrust laws, laws that are essential to making the free enterprise system work. That bothers me. That concerns me, because an administration that has cloaked itself in as strong an image of being pro-free enterprise has, in this Senator's opinion, failed to do that which is so necessary to support that free enterprise system and that is to see that free competitive forces have an opportunity to work and to work well.

The antitrust laws are not enacted by Republicans over the objections of Democrats or by Democrats over the objections of Republicans or by liberals, conservatives. It was a joint undertaking.

An antitrust enforcement is not a partisan cause. I am not here this morning to beat on the Republican administration as a political matter, I am here because I am concerned about the free enterprise system. I am a product of that system. I came out of the business world. I was the chairman of the board of a company listed on the New York Stock Exchange, one on the American Stock Exchange, and another in the over-the-counter market, and I want the system to work well.

Effective antitrust enforcement in my opinion is one of the Nation's most basic economic policies, supported by leaders of both political parties, from Republican Senator John Sherman of my own State, who caused the Sherman Antitrust Act to come into being,

to Teddy Roosevelt, Richard Nixon, Jimmy Carter, Gerry Ford, and so many others.

The administration, I am concerned, has abandoned this tradition of effective antitrust enforcement. Every piece of legislation it recommends, every policy pronouncement it makes has one basic message, relax, relax the antitrust laws, let big business do what it wants.

There is considerable hullabaloo that antitrust is some-how throttling our Nation's competitive position in the international markets. I have said it before and I will say it again: If there is something in our antitrust laws that throttles the American business community and its opportunity to compete fairly and effectively, and it can be proven—and it can be proven, that that really is affecting our business corporations in this country and their ability to compete internationally, then this Senator is prepared to look at those proposals.

But when the administration comes along, it comes along with a broad brush and it says create this big new hole so that business can compete effectively on an international basis. If it can be proven that such an amendment is necessary, I am willing to take a look at it, but do not come just with a speech, come with some evidentiary facts.

Businessmen today are being advised that this is the time to merge because the green light is on. Lawyers and others are saying publicly that in the past we would not have even tried to make this merger, but with this administration they are worth trying.

Mergers like Coca-Cola and Dr. Pepper, Pepsi and 7-Up, U.S. Air and Piedmont, Santa Fe and Southern Pacific, and Republic and Northwest would never have been attempted in any other administration, Democratic or Republican.

Has the economy benefited from this massive merger wave? I think not, and I think the facts will bear me out. American firms are not more competitive today than they were six years ago. The trade deficit is now at record levels. Millions are unemployed in our basic manufacturing industries.

I believe, and I think the evidence will support my belief, that this administration's lax antitrust enforcement policies have not been good for the economy. They have not been good for the country. They have not been faithful to the law.

We have witnesses this morning who may say we brought this many cases, we did this, we did that. Well, the fact is that there is merger mania that is rampant in this country today and it is not serving the Nation well.

I am realistic enough to know that we may not be able to convince the administration to enforce the antitrust laws more vigorously. We cannot turn a knob and say do it and expect that they will. We can, however, give the public a better idea of what this administration's policies really are and we can shed some light on how it has enforced or has failed to enforce the law.

I cannot tell you how pleased I am about the fact that the ranking member of this committee, Senator Thurmond, is with us this morning. Senator Thurmond and I do not always agree, but in many instances we have agreed and where we have agreed we have made an effective team.

We have worked together to change the laws with respect to the Antitrust Improvements Act we passed several years ago, and we have worked together to defeat some legislation to open even wider some of the exemptions in the antitrust law.

Senator Thurmond, I know, shares my concerns and my concepts about the free enterprise system being so vital and so integral to our Nation's economy. So I am very pleased that he is here with us today. I have no idea what his remarks or thrust will be, but I say to you very publicly, it is a privilege to work with him and, although some may think that because he is so liberal and I am so conservative, we might disagree often, but the fact is we get along very well.

I am happy to have you with us, Senator Thurmond.

Senator THURMOND. Thank you, Mr. Chairman. You are a fine fellow, but after hearing that talk I am convinced you are among the forefront of the Democratic leaders. [Laughter.]

Mr. Chairman, merger law enforcement is a vital and prominent part of antitrust law. A substantial part of the antitrust budget of the Federal Trade Commission and the Justice Department is committed to merger screening, merger analysis and merger litigation.

The primary focus of merger enforcement is on mergers between directly competing firms and this is as it should be. Acquisitions and mergers between firms and unrelated lines of business may often make large headlines and involve great sums of money, but rarely raise any antitrust problems because they rarely reduce competition.

In recent years, the Justice Department and the Federal Trade Commission have published guidelines describing the way those agencies analyze proposed mergers. Those guidelines only reflect court decisions and trends in the law. They do not make law. They aid law enforcement by assisting the businessmen and their legal counselors to comply with the law.

Those guidelines indicate that the antitrust authorities are selective, as they should be, because they do not want to lose cases. It does not strengthen the force of antitrust law for the government to bring and lose weak cases.

The Justice Department and the FTC are still concerned with concentration in markets. They look at the size of merging firms and the size and number of the other firms left in the market. They also look at the abilities of still other firms to enter the market and offer further competition where there is room for additional competitors.

These conditions of entry into a market are important, where the market is a geographic area that a new supermarket might enter, or a product line that a new computer equipment maker might enter. Many such factors go into the analysis of the likely effect of a merger on competition.

It may be tempting to second-guess a particular prosecutorial decision on a high-profile merger, but to do so ignores the enormous amount of painstaking analysis of merger transactions and the careful evaluation of those transactions as potential lawsuits under prevailing judicial standards. Those judicial standards are not partisan matters. They were changing before the current administration began and they will continue to evolve.

Now, I believe the distinguished Chairman spoke about the economic situation under the administration. I would merely state that under the previous administration, before President Reagan came into office, inflation was 12.5 percent. It is down now to about 2 percent or less. I would remind the Chairman that when President Reagan took office, interest rates were about 21.5 percent. The prime now is down to between 7 and 8 percent.

I would remind him that we have more people employed today than we have ever had in the history of this country. So the situation as I see it from an economic standpoint has greatly improved over the previous administration.

Now, I would close by commending Mr. Rule and the Justice Department. I think Mr. Rule has done a fine job. He is able, he is dedicated. I also want to commend Mr. Oliver, too, who has served in the Agriculture Department as General Counsel, he served in the Education Department as General Counsel, and he is a very capable and dedicated man with the FTC.

I commend both of them for the work they have done in the merger area, and I welcome all of our witnesses today on all sides of this important issue, whether you agree with my position or not.

Again, Mr. Chairman, I am glad to be with you and to cooperate when I can. On matters we differ, I am sure you can understand that our philosophy is somewhat different.

Now, I have got three committee meetings going on this morning, so I am going to have to leave in just a few moments, but I will be interested in being briefed on this testimony. I want to know what each witness had to say and why he said it. So Mr. Chairman, I am very pleased to stay as long as I can, but I will have to leave in a few minutes.

Thank you.

Senator METZENBAUM. Thank you very much for being with us at the opening of the meeting, and I appreciate the pressure of other committee hearings. We are glad to have you stay as long as you can.

Mr. Oliver, I understand that you have a commitment to be elsewhere and we will try to get you in and out as quickly as possible. You know of our 5-minute rule and we would be happy to hear from you, sir.

A PANEL CONSISTING OF: DANIEL OLIVER, CHAIRMAN, FEDERAL TRADE COMMISSION; AND CHARLES F. RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. OLIVER. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am pleased to testify here today on behalf of the Federal Trade Commission and to summarize our enforcement efforts of 1986.

The Commission's investigation of a merger most often begins with the receipt of a pre-merger filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

In 1986, the Commission received filings for the largest number of transactions since the pre-merger notification program became

effective in 1978. The distribution of these filings over the year was unusual and instructive.

The number of transactions reported in the first half of the year was only slightly above the number reported during the same period in 1985, while the number of transactions reported in the last 5 months of 1986 was 73 percent more than the number reported in the last five months of 1985. We suspect that this deluge of filings at the end of the year was prompted by impending changes in the Tax Code and not by any underlying economic forces.

When a filing raises serious antitrust issues, the Commission and the Justice Department are empowered to request additional information. The number of transactions in which second requests were issued during 1986 increased to 93 in comparison with the 84 second requests issued for filings received in 1985. As a percentage of transactions reported, however, second request decreased from 4.8 percent to 3.9 percent.

Despite the decrease in the percentage of transactions involving second requests, the Commission took action against more mergers in 1986 than in most prior years. The Commission voted to block or obtain advance consent agreements in eight transactions in 1986; in seven of those transactions, the Commission was successful in preventing the transaction or in negotiating divestitures designed to preclude any adverse effect on competition.

In comparison, between 1979 and 1985, the Commission voted to challenge or obtain advance consent agreements in an average of fewer than six transactions per calendar year. In only one prior year, 1981, were more transactions challenged before their consummation.

In addition to its direct responsibility for reviewing mergers, the Commission must insure and safeguard the vitality of the pre-merger notification program. The Commission continually reviews its pre-merger notification rules in order to insure the effectiveness of the program. For example, the Commission recently adopted several amendments to its rules designed to reduce the burden imposed by the program on the public, without compromising its ability to challenge any competitive mergers.

The Commission has also proposed an amendment to the rules that would close the so-called partnership loophole under which some persons have attempted to avoid filing pre-merger notifications, acting through partnerships rather than controlled corporations.

I would conclude by observing that the Commission does not and should not measure its effectiveness simply by the number or percentage of transactions that we challenge. Our goal is to challenge only those transactions that may lessen competition and therefore to refrain from interfering with the transactions that have no anti-competitive effect.

As in earlier years, in 1986 we did not intervene in most mergers that we reviewed because they were unlikely to have an adverse effect on competition. In those cases where mergers threatened competition, we moved decisively to challenge them.

Thank you, Mr. Chairman. That concludes my prepared statement and I would be happy to respond to any questions you may have.

Senator METZENBAUM. Thank you very much, Mr. Oliver.

Mr. Oliver, I am concerned about a merger that occurred in the fall of last year between May Department Stores and Associated Dry Goods Company. Both were retail store holding companies, both had annual sales of between $4 and $5 billion. I wrote you a letter about that merger, urging the Commission to take a careful look at the effect that merger would have on competition and consumer prices. In my letter, I pointed out that the merger would create the second largest department store company in the world, a 609-store firm, with $9 billion in annual sales.

The question I have is did the FTC do anything to challenge all or part of that merger?

Mr. OLIVER. Senator, the staff of the FTC looked at that merger. I guess some of those facts remain confidential, of course, but the staff came to a conclusion that, although the figures I do not doubt are as you say, there was no anti-competitive effect on consumers from the merger. The question would not have been just the size of the merger but whether it would be an effect on consumers who make purchases as a result of the merger.

Senator METZENBAUM. Let me just follow that answer of yours a little further. In eleven metropolitan areas, they were the co-anchors in 19 shopping centers nationwide. In three areas, Youngstown-Warren, in my own State, Pittsburgh, Pennsylvania, and Fort Collins, Colorado, the merger would have given the May Company total control of comparable department store sales.

Now, what concerns me is why did the FTC ignore these facts? I mean these are real cases where the consumers had to be hurt. You were going to eliminate any major competitive factors in those shopping center areas as well as the communities. And what concerns me is why did the FTC ignore these factors and let the merger proceed? Then, as if to prove the point, as you well know, the Pennsylvania Attorney General was concerned enough to file suit to block the merger. As you also know, he brought about a rather good result in causing them to get rid of some of those stores and to keep the competitive factor in that area.

Mr. OLIVER. Senator, I do not believe that the staff ignored the facts that you mentioned, but I would point out that there are lots of other places where consumers can buy goods than in department stores. I am sure that that was one of the factors that the staff considered and came to a conclusion that there would not be any harm to consumers resulting from the merger, given the number of outlets that are available for consumers to make purchases in.

Senator METZENBAUM. Well, let me point out to you that the May Company just recently announced the closing of nine associated company retail stores in Colorado and people of Colorado certainly have to be concerned about the effect this announcement will have both on competition and jobs in that State, and the people in Pennsylvania were sufficiently concerned that the Attorney General of Pennsylvania went into court, and my recollection is that he got them to agree to sell off either the May stores or the Associated stores before the transaction was concluded. So it seems to me that the evidence is rather strong that there is an impact upon consumers.

Mr. OLIVER. Senator, let me make two points in response, if I may. One is that if they are selling off the department stores in Colorado, that suggests, at least to the corporate managers of those department stores, that they are not as profitable as they would like, which might suggest that in fact the consumers do not make the kind of use for them that they might. I do not know, I am simply speculating.

But I would also point out that my understanding is that a number of companies have expressed interest in buying those stores. If those stores are in fact bought by other companies they will remain in the neighborhood and be available for consumers to shop at.

Senator METZENBAUM. But the point I am making is they were operating stores, there was no talk of closing them before the merger took place. Then they made an announcement that they were closing those stores. Now, whether or not somebody else would come along and buy them, I do not know, but it is reasonable to assume that nobody had come forth and indicated a willingness to buy them. I do not know what the case was.

What I am talking about is the FTC obligation to come in on a situation where it is obvious that competition is going to be eliminated or vastly cut down, as in the Pittsburgh situation, as in the Colorado situation.

Let me go to another issue, because I do not think we can beat that dead horse. You did not do it, you should have done it. You think that you acted appropriately.

Mr. OLIVER. Yes, sir.

Senator METZENBAUM. I tell you that I do not believe the people of Pittsburgh or Colorado agree.

In 1985, the FTC reviewed a merger between Whirlpool and Kitchen Aid, the third and fourth largest firms in the highly concentrated major home appliance market. The Commission allowed the merger to go through, despite the extremely high concentration that would result and the high barriers to entry in that industry.

It is not easy to get into that industry. You have got to have a name, you have got to have a marketing operation, you have got to have patents. Despite FTC approval of the merger, two appliance manufacturers brought suit to enjoin the merger and they won. They won. The Federal court agreed that the merger would dangerously increase market concentration.

Under those circumstances, when the courts have acted at instance of private individuals, how can the Commission justify failing to challenge this merger when the court found it to be clearly illegal?

Mr. OLIVER. Senator, I was not at the Commission in 1985 and I know none of the facts involving that merger. I really think I probably cannot comment on your question.

Senator METZENBAUM. I might point out to you that in Commissioner Bailey's dissent, she made it clear that this is a horizontal merger between the third and fourth largest firms in a highly concentrated market characterized by high entry barriers.

From the point of view of the predictive value of the Department of Justice guidelines, the only extraordinary thing about it may be the Commission's decision not to challenge it.

She went on to say the question now is what standards are going to be applied by the FTC in evaluating mergers in this and other industries to define those extraordinary cases in which the high HHI numbers will be disregarded.

Let me not beat a dead horse. You were not there. But let me make it clear that I think we in Congress expect the FTC to do the job that it has the responsibility to do, that we will support you when you do so, and that we do not think it is just a question of political philosophy. We think it is a question of support for the free enterprise system and that to me is the bottom line.

Thank you, Mr. Oliver.

Mr. OLIVER. Thank you, Senator.

Senator METZENBAUM. Mr. Rule, we will be very happy to hear from you now, sir.

Mr. RULE. Thank you, Mr. Chairman and members of the Subcommittee. You have copies of my rather lengthy prepared text and I understand that will be put in the record. All the members have it and, rather than trying to read it, I thought I might try to summarize a few of the main points that I have made there.

Senator METZENBAUM. Without objection, your entire statement, as well as Mr. Oliver's, will be included in the record.

Mr. RULE. Thank you, Mr. Chairman.

I did want to make a few points. The first one, which I think is the most important, is that an active merger market, a large number of transactions is not in and of itself inconsistent with appropriate protection and enforcement of the antitrust laws.

Transactions take place in a market, in the merger market similar to any other market. They involve moving assets from lower valued uses to higher valued uses, based on individual participants, estimations of how much the assets will be worth in their hands.

The transactions that we have seen lately are motivated by a number of concerns. Many, and I would say with the exception of a tiny fraction, are motivated by concerns with which the antitrust laws never have and probably never should interfere.

First and most importantly, these transactions are responses to economic changes and I think, as we all know, this economy has undergone tremendous change over the last 10 to 15 years. We have seen increased foreign competition and firms have attempted to respond in some cases to mergers. We have seen fluctuations in exchange rates by very substantial margins. We have seen changes in the tax structure. We have seen other changes, and all those have an effect in the market, an effect on forces of supply and demand, and firms respond to them one way they respond is through transactions that come under the heading of mergers and acquisitions.

The mergers and acquisitions occur in response in order to obtain efficiencies, to allow the firms to provide goods at lower cost. They are an attempt to discipline management that perhaps has not been watching out after the best interests of the shareholders. They involve the changing hands of assets in order that the assets might be used in new ways that increased efficiency and deal better with market forces.

There is no doubt that in many of these cases mistakes are made. Individual parties make mistakes in guessing what they can do

with the assets, they overestimate the efficiencies that are available, they may overestimate the tax benefits that are available--all those things happen, no question about it, but the market disciplines those people when they make those mistakes.

Our track record in terms of trying to guess whether or not somebody is making a mistake, I think it is pretty clear, would be no better than the individual parties who are betting their money.

It is only if the merger is an attempt to achieve private gain at the expense of consumers in the form of higher prices that the antitrust laws condemn the transactions, and only in those cases that we in the Antitrust Division should step in. That is the law, that is the way we enforce it, and that is the way we should enforce it and that is the way we will continue to enforce it.

I think it is very important to stop those mergers because they are harmful to the economy, they are harmful to the consumers, and in that I think we have an area of common agreement.

I think, though, that if you just look at the statistics in a general way, without trying to get down and look at individual cases, you can get a misleading picture. For example, a great deal is said about the current merger wave, and it is true that there have been a large number of mergers relative to the number of mergers in the mid-to late-seventies.

On the other hand, there are fewer mergers occurring today, last year in particular, than there were in 1969, substantially fewer. Also, many of the mergers or many of the transactions that are called mergers are just as likely to deconcentrate markets in the economy.

For example, many of the transactions that are listed as mergers and are filed under Hart-Scott-Rodino involve divestitures, leveraged buy-outs that really move assets from larger companies to smaller companies or create new companies. Companies such as Standard Oil of Ohio, in your own State, Senator, Allied Signal, Dow Chemical and others have engaged in a series of transactions to realign their asset portfolio in a way that they think will make them more competitive, but the effect has been to make them to some extent down-sized firms.

And I think if you look at the economy-wide concentration statistics, you will see that economy-wide concentration measured in terms of the assets held by the top 100 or 200 firms is still below the level of economy-wide concentration in 1970. Also, if you look at the percentage of employment held by those firms, you will see that it is much lower than it was in 1970 and it continues to decline.

So I think if you look behind the statistics at some other factors, you will see that the situation is not that bleak.

I think more importantly, if you look at the individual transactions as opposed to these statistics, you will see that we are appropriately enforcing the antitrust laws. We are using the Merger Guidelines. The Merger Guidelines are the standards that we apply to the mergers, we use the definition of markets there, we use the concentration numbers there, we look at all the relevant evidence to determine whether or not there is going to be an anticompetitive effect, and if there is we challenge the merger, as we have indicated on six occasions in the first part of fiscal year 1987.

As I said, the statistics can be and are to some extent misleading. There is no reason to believe that there is a fixed proportion of mergers that will be challenged for every merger that is proposed. That is, because we challenge perhaps 1.5 percent of the mergers that were presented under the Hart-Scott-Rodino Act seven years ago or eight years ago does not necessarily mean that 1.5 percent of a larger number of merger transactions will also be challenged this year. Other things have relevance, the most important of which is the merger guidelines which have made merger enforcement much more certain, have enabled firms to avoid antitrust problems, have enabled them to go ahead and respond to these economic changed that I have talked about without violating the antitrust laws. I think that is a good thing, that is probably why we see much fewer challenges, but in seeing the red light is on, I will just close by saying that where there is a violation of the antitrust laws, where there is likely to be an adverse effect on competition, where there is likely to be an adverse effect on prices that consumers have to pay, we will step in and challenge those mergers.

But if there is not such an effect—and I think our monkeying around in the economy, without serving the purposes of the antitrust laws as they are written, is detrimental to the economy, counterproductive, and I hope that after the Committee searches the record they will reach that conclusion as well.

Thank you.

[The prepared statement of Mr. Rule follows:]

STATEMENT

OF

CHARLES F. RULE
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to discuss this morning the subject of mergers and acquisitions and the role of the Department of Justice in enforcing the antitrust laws with respect to such transactions. Merger activity is an extremely important aspect of the way in which our free market economy functions, and I believe the Department's merger enforcement activities have been appropriately sensitive to this fact at the same time that they have served to prevent anticompetitive mergers that threaten the well being of consumers.

The Benefits of a Dynamic Market for Corporate Control

Before discussing the Department's merger enforcement policy and the process by which we analyze the likely competitive effects of these transactions, it is important to review the crucial role that mergers and acquisitions play in the economy. It is now widely recognized that mergers can and often do perform beneficial functions.

A merger or acquisition simply represents the movement of assets from lower to higher value uses, at least from the standpoint of the parties to the transaction. While the parties sometimes make mistakes in predicting those values, unless there is a substantial probability that the merger will result in private gain at the expense of the public--i.e., through the creation of market power--there is no reason for the government to second-guess those predictions. Moreover, a dynamic market in corporate control, free from unnecessary public or private restraints, is essential to the economy's ability to meet changing conditions, such as the increasing importance of foreign competition.

Mergers can result in the realization of joint operating

efficiencies, economies of scale, economies of scope, and financial economies, and may in many circumstances help domestic firms meet their international competition. A merger can provide efficient access to resources for both parties to the transaction leading to new or better products than either firm alone could develop successfully. The existence of a vigorous and competitive market for corporate control helps to discipline managers better to serve stockholder interests. In this way, mergers identify undervalued assets, causing them to be more appropriately valued or redeployed in more efficient uses.

Of course, particular mergers do not always have their hoped-for beneficial effects, which is to say that businessmen and women sometimes make mistakes, but that is neither surprising nor avoidable. Even though a merger may not, in the final analysis, yield the economic benefits expected by the parties, it is the parties involved who stand to win or lose based on whether the merger will increase the value of their assets. And indeed, it is the parties themselves who likely are in the best position to evaluate the potential economic benefits of a merger. In enforcing the antitrust laws as they apply to mergers, the government therefore cannot and does not second-guess business decisions unless there is some demonstrable competitive harm.

Moreover, the Department's antitrust enforcement mandate does not, and should not, authorize interference with mergers and acquisitions in order to protect private vested interests--be those the interests of the acquired firm's management, the acquirer, or anyone else. The antitrust laws are based on our nation's fundamental belief that the discipline of free and open competition in the marketplace ensures the best allocation of resources and that this discipline best satisfies consumer welfare. Thus, the Department challenges only those acquisitions that are likely to lessen competition substantially, and thereby harm consumers by increasing the ability of one or more firms in the affected industry to exercise market power.

The Department's Merger Enforcement Policy

As many observers have pointed out, there recently has been an increase in merger activity. This increase should not be viewed with concern. Given the changes in the economy, changes in tax laws, and the tremendous increase in the value of publicly traded corporations, it is hardly surprising that there would be an increase in mergers designed to respond to these factors. There is no reason to believe that more than a tiny fraction of these mergers have been anticompetitive, and those have been challenged by the Federal Trade Commission or Department of Justice. The increased certainty of the antitrust rules applicable to mergers that has resulted from the Department's Merger Guidelines has made it easier for businesses to avoid antitrust concerns as they seek to achieve legitimate ends in the market for corporate control.

Furthermore, the increase in mergers has not brought about a significant increase in economy-wide concentration. The percentage of assets held by the top 100 and top 200 corporations in the United States remains below the levels of 1970; at the same time, the percentage of employment accounted for by the top 100 and top 200 corporations continues to decline. In fact, a substantial proportion of recent takeovers and acquisitions has involved divestitures that were deconcentrating.

Enforcement of the antitrust laws against harmful mergers and acquisitions is and throughout recent memory always has ranked as one of the top two antitrust enforcement priorities in the Department of Justice, along with the detection and prosecution of criminal, cartel-type behavior such as price fixing, bid rigging, and market allocation among competitors.

The primary antitrust law relating to mergers is section 7 of the Clayton Act, which prohibits mergers and acquisitions that may substantially lessen competition in any line of

commerce in any section of the country. In evaluating the legality of mergers under this statute, courts and the Department employ the principles enunicated in recent Supreme Court precedent, and those articulated in the Department's Merger Guidelines. As I will detail in a moment, the Guidelines describe how we define relevant product and geographic markets, assess effects on concentration brought about by a merger in those markets, and weigh other factors that are crucial to legally and economically sound merger analysis. The absolute size of the transaction or of the resulting firm is not in itself of great significance in antitrust merger analysis. Rather, as the courts have made clear, the crucial issue is whether a merger is likely substantially to lessen competition in the specific markets in which the parties to the merger are actual or potential competitors. It is such mergers and only such mergers that threaten consumers with anticompetitive increases in the prices they pay for the myriad of goods and services they require.

As the Subcommittee knows, the Department of Justice shares antitrust enforcement responsibility in the merger area with the FTC. The Hart-Scott-Rodino Act, which requires notice to the agencies of significant mergers and acquisitions prior to their consummation, is an invaluable tool in fulfilling this responsibility. Premerger notification, clearly the most significant procedural aspect of antitrust enforcement in the merger area today, provides the Department and the FTC with both the information necessary to analyze likely competitive effects and the opportunity to challenge those transactions that threaten to harm consumers before they can be consummated.

As we recently reported to the Subcommittee in connection with its hearings on the premerger notification rules, on the basis of its experience with the program since its inception, the Department believes that, in general, the balances and lines drawn by Congress when it formulated the statutory outline of the program in 1976, and by the FTC in its

implementing regulations since that time, have facilitated effective antitrust enforcement without undue expense to firms and investors engaged in corporate reorganization efforts. The Department has had adequate opportunity to review potentially anticompetitive transactions under the program: antitrust enforcement has not been prejudiced by "midnight mergers." We have been able to obtain adequate information on the likely competitive effects of mergers through use of our premerger authority and other investigatory tools. We also have had sufficient opportunity to seek any necessary preliminary injunctive relief in the courts.

In general, mergers and other acquisitions subject to Hart-Scott-Rodino reporting requirements may not be consummated until at least 30 days notice has been given (15 days in the case of cash tender offers). Each such notification is carefully reviewed for possible anticompetitive effects. If either agency desires to conduct an investigation of the merger, it makes that desire known to the other agency through our long-standing liaison procedure, and a determination is made as to which agency will continue to review the transaction in order to avoid duplication of effort. After further investigation, the agency conducting the investigation may issue a request for additional information from the parties. Such a so-called "second-request" letter, made within the initial waiting period extends the waiting period an additional 20 days from the date of compliance with the request (10 days in the case of cash tender offers).

The Department of Justice utilizes its Merger Guidelines in analyzing the likely competitive effects of mergers and acquisitions. The current Guidelines were substantially revised in 1982 to reflect existing economic knowledge and evolving legal precedent on the likely competitive effects of merger transactions, and were updated again in 1984. Their primary focus is on horizontal mergers--mergers between actual or potential competitors--and if our analysis leads us to conclude that a merger threatens adversely to affect a market's

competitive performance, either by facilitating collusion among the remaining firms or by creating or expanding a single firm with significant market power, the Department is ready, willing, and able to block it. Our recent efforts regarding the Baker/Hughes, MacAndrews & Forbes/Metrocolor and Baxter Travenol/American Hospital Supply acquisitions merely illustrate our continuing resolve to interdict acquisitions that threaten to harm competition.

Merger Analysis

The first step in our analysis is to identify and measure the product and geographic markets that are affected by the merger. The Guidelines set out in detail the principles we employ to derive the appropriate relevant market or markets. We then measure the degree of concentration in those markets and the amount by which the merger would increase market concentration utilizing the Herfindahl-Hirschmann Index ("HHI") of market concentration. This measurement takes into account not only the size of the firms in the market, but also the distribution of their market shares giving proportionately greater weight to the market shares of the larger firms to account for their likely relative importance in any collusive activity. The Guidelines provide the general standards that we employ to characterize markets as unconcentrated (HHI below 1,000); moderately concentrated (HHI between 1,000 and 1,800); and highly concentrated (HHI above 1,800).

The HHI calculations are the beginning of the inquiry into whether the merger is likely to increase market power. The Guidelines go on to explain how we analyze the significance of other factors in evaluating the likely competitive effects of mergers, including changing market conditions, the financial condition of firms in the market, special factors applicable to foreign firms, and ease of entry into the market. Claimed efficiencies are also factored into the analysis to the extent they can be demonstrated. Finally, the Guidelines set out the Division's application of the "failing firm" and "failing division" doctrines. Only when we have evaluated all the

relevant facts and circumstances can we predict with any degree of certainty the likely competitive effects of a proposed merger.

Recent Merger Investigations and Challenges

Merger analysis and enforcement today is a sophisticated economic exercise. Depending on the transaction, the Department's attorneys and economists may be called upon to define and analyze likely competitive effects in many relevant markets. During calendar year 1986, the Department received almost 4,000 Hart-Scott-Rodino premerger filings covering some 2,400 transactions, and 1,700 applications for mergers involving banks and other depository institutions. A substantial majority of the mergers reported to us prove after brief inspection to be obviously of no competitive consequence: early termination of the Hart-Scott-Rodino waiting period was granted by the Division and the FTC with respect to approximately 1,600 transactions in 1986. Others require more lengthy scrutiny. During calendar year 1986, the Division initiated 92 formal investigations of Hart-Scott-Rodino reported transactions, and investigated 27 depository institution mergers. We used our important premerger authority liberally, making 81 requests for additional information following Hart-Scott-Rodino notification in connection with 40 of our investigations.

During the last three months of 1986, the Department received notice of a record number of premerger notifications: nearly 1650 filings covering some 980 transactions. This represents almost three times the number of filings during equivalent periods in the past. A large proportion of these transactions undoubtedly was prompted by the recent changes in the tax laws.

In order to ensure that we thoroughly examined all those transactions that raised competitive issues, at the request of the senior legal staff, we temporarily modified our initial screening procedure. Our economists conducted initial screenings, sifting out those transactions that were obviously

of no competitive significance, and freeing up our attorneys to focus on those that raised possible competitive problems. Our attorneys and economists performed admirably during this period, and we have now returned to our normal premerger screening procedure, under which initial review is performed by both attorneys and economists.

Recent challenges to anticompetitive mergers by the Department provide a cross section of the types of markets the Department's enforcement efforts have sought to protect. One case brought in fiscal year 1986, United States v. Baxter Travenol Laboratories, Inc., et al., involved competitive overlaps in health-care equipment markets that totalled $1.7 billion in sales, and the decree entered to settle that case required divestiture of assets worth more than $200 million. Other cases brought in fiscal year 1986 challenged mergers and acquisitions in such industries as riverbank stabilization devices, mobile telephone service, motion picture theatres, electronics, and embossing machinery.

During the first four months of fiscal year 1987, the Department of Justice filed four merger cases and announced its intention to file two more. In November, the Department challenged the acquisition by Rohm and Haas Company of the ion exchange resins business and assets of Duolite International, Inc., a subsidiary of Diamond Shamrock Corporation. The Department alleged that the consummated acquisition would substantially lessen competition in the production of ion exchange resins for sale in the United States. The consent decree settling the suit required divestiture of the Duolite ion exchange resin plant in Redwood City, California, and a non-exclusive technology license for manufacture and sale of Duolite ion exchange resins.

In December, the Department challenged MacAndrews and Forbes' proposed acquisition of Metrocolor Laboratories from Lorimar-Telepictures, alleging that the proposed acquisition would violate the Clayton Act by substantially lessening competition in the production of 35 millimeter release prints

for nationally distributed motion pictures (so-called "wide-release" prints), as well as competition in the production of 70 mm release prints. The proposed acquisition would reduce the number of film laboratories used by U.S. motion picture studios for producing 35 and 70 mm release prints for major motion pictures from three to two, resulting in a greater likelihood of higher prices for both studios and moviegoers.

In January, the Department filed suit to block a merger of Rheem Manufacturing Company of New York City and Bradford-White Corporation of Philadelphia, the third and fifth largest manufacturers of residential water heaters. The Department alleged that the merger would eliminate all competition between the two firms and lessen competition generally in the sale of residential water heaters. After we filed suit, the parties abandoned the merger.

In January, we announced our intention to file a suit to block the merger of two of the world's largest providers of oil well drilling equipment--Hughes Tool Company of Houston, Texas and Baker International Corporation of Orange, California. Our suit would allege that the proposed merger would substantially lessen competition in two markets--the market for tricone rock bits and the market for electric submersible pumps used in oil wells. Each of these markets currently has only four significant competitors. The merger would reduce the number of competitors to three in each market and would create a dominant firm with market power in the tricone drill bit market.

In February, the Department filed a complaint challenging Domtar, Inc.'s acquisition of the gypsum board business of Imasco Limited. Imasco and Domtar, both headquartered in Montreal, are the fourth and fifth largest producers of gypsum board in the United States. We alleged that the proposed acquisition would substantially lessen competition in the manufacture for sale of gypsum board in the Pacific Southwest. That suit was settled by the filing of a consent decree providing for the divestiture of Imasco's gypsum board plant,

gypsum rock deposits, and all sales facilities in the Pacific Southwest market.

We also have announced our intention to sue to block Ethyl Corporation's proposed acquisition of Dow Chemical Company's Bromine and Brominated Chemicals Division. That suit would allege that the acquisition would substantially reduce competition in the market for brominated clear brine fluids. Brominated clear brine fluids are dense fluids used in oil and gas well completions and maintenance programs to counterbalance the pressure of the wells in order to prevent blowouts or geysers. The parties have expressed their intention to negotiate promptly a consent decree with the Department that would provide for the sale of Dow's clear brine fluids plant in Magnolia, Arkansas, to a third party.

I am particularly proud of the Department's attorneys and economists over the recent period in which merger activity increased substantially, and in which several merger lawsuits or threats thereof were required within a very short time. The Department is committed to sound antitrust enforcement in the merger area. We should not, and indeed under the prevailing judicial interpretation of section 7 could not, challenge a merger unless it creates a substantial threat to consumer welfare. Where a merger does create such a threat, however, the Department has demonstrated its willingness and ability to step in to prevent the offending aspects of the merger.

Needed Legislation--The Merger Modernization Act of 1987

Before closing I would note that minority leader Dole (with co-sponsors Senators Simpson and Cochran) and the Ranking Minority member of this Committee, Senator Thurmond (with Senator Cochran as a co-sponsor) have introduced the Administration's "Trade, Employment and Productivity Act of 1987," S. 539, and a shorter version of that bill, S. 635, respectively. Titles IV and II of those omnibus bills include several provisions for reform of the antitrust laws. The five

subparts of those titles are designed to effect much needed changes in the nation's antitrust laws in five areas: merger analysis, antitrust remedies, interlocking directorates, extraterritorial application of the antitrust laws, and claim reduction. The Department of Justice strongly believes that these proposals represent important antitrust reforms that will significantly benefit competition and consumers.

Of specific relevance to today's hearing are the proposed revisions to section 7, which were contained in the "Merger Modernization Act of 1986" introduced in the last Congress. While some have characterized these as proposals to allow mergers essentially "at will," this is emphatically not their purpose and would certainly not be their effect. Rather, we are proposing three specific revisions to section 7, each of which would promote sound antitrust merger analysis and would continue to prevent anticompetitive transactions.

We have proposed new language in section 7 to make it clear that that statute deals with probabilities, not mere possibilities, of consumer harm, with market power as the consumer harm to be avoided, and with sound economic analysis as the key to a rational decision on the lawfulness or unlawfulness of any particular merger. These changes will codify our present merger enforcement policy. I refer you to the testimony of the Attorney General before the Senate Judiciary Committee concerning S. 2160 on April 9, 1986, which

was delivered by Assistant Attorney General Douglas H. Ginsburg, for a more detailed explanation of the benefits of this reform. It is hoped that this language, along with the other antitrust provisions I have mentioned, will go a long way toward improving American competitiveness by clarifying the intent and effect of our antitrust laws as interpreted by the courts and the enforcement agencies.

Conclusion

The Department of Justice's merger enforcement policy recognizes the importance that mergers and acquisitions play in our economy and is in keeping with current economic thinking and judicial decisions about both the beneficial and harmful effects that they can have. The Department has enforced and will continue to enforce the antitrust laws with respect to mergers to ensure that those transactions that threaten significant harm to consumers are not permitted to occur.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions that you or other members of the Subcommittee may have.

Senator METZENBAUM. Mr. Rule, I would hope that you would actually go back and read the first portion of the last sentence you gave us, because I think if you did proceed on the basis that you have outlined in that first portion, until you got to the word "but," I think that we might be a lot happier with your actions.

One of our concerns is that you are not doing that which you enunciated so well in the first part of that last sentence, where you say where you see it affect competition, where it will have an impact upon the consumers, that is all very well and good. I just would hope that you would proceed in that manner.

You also mentioned in your statement that the matter of deconcentration being a result of mergers. Frankly I just have to challenge you sharply on that and actually challenge a portion of the basis that you use to set that up, in order to claim credit for the deconcentration.

It is true that in connection with many leveraged buy outs companies wind up selling off their assets. Those are not mergers that you are talking about, those are leveraged buy outs and those are a question of selling off the assets to pay off the junk bonds. So I do not think that that really has to do with the issue of mergers. That is an entirely different issue, one that I think we all have a concern about, but I do not think it fits into these parameters.

The second thing is that you said that the effect of these mergers has been to down-size firms. Well, I do not know that I agree with that at all. When you find two corporations merging, then they may sell off some little piece or maybe in some instances a larger piece. When Limited tried to buy Carter-Hawley-Hale, we recollect so well that Carter-Hawley-Hale gave a special deal to Walden Books, but it had nothing to do with competitive aspects, it had to do with fending off an effort on the part of Limited to take over the company. We know of many other instances of the same nature. We know that this was not a merger.

But when Sir James Goldsmith came along and moved in on Goodyear, we know that the company paid him about $130 million in order to meet that obligation and wound up selling off a major portion of its assets. We see that happening.

These are not the issues about which we are concerned. We do have a concern, but for a totally different reason. It does not fit into the merger aspects. Here we are concerned about mergers.

Now, I have a number of questions, but I see that my colleague, Senator Humphrey, is——

Senator HUMPHREY. I have no statement. Go ahead.

Senator METZENBAUM. Thank you.

Ten days ago, Mr. Rule, I sent you a letter requesting information for this hearing. The letter asked for information about the department's enforcement record and for staff memos in cases in which staff recommendations to challenge mergers were overruled. In my letter, I asked that you furnish the information by the end of the day Monday and that you call if you anticipated any problem.

On Monday, at 6:00 o'clock in the evening, you informed my staff that you were not furnishing the memos at the time requested. You now have said that you may refuse entirely to submit them.

Can you tell me today whether you will refuse to submit that information or will you definitely furnish these memos, or are you invoking executive privilege?

Mr. RULE. Let me respond to that question in just one minute, but I did want to respond to one thing that you said before, because I did not want to leave a misimpression, and I am glad to hear that you recognize that these mergers that are deconcentrating buy-outs and divestitures are not part of the issue, that there are other concerns that are not antitrust concerns, I would agree with you.

The reason I mention that fact is that frequently our record in enforcement is criticized on the basis of a large number of transactions and a small number of merger challenges. I was simply making the point that every time I have ever heard the statistics of a large number of transactions mentioned, that large number of transactions contain at least a third or maybe 40 percent divestitures, and some other fraction and a much larger fraction probably of mergers that do not involve competitors.

I agree with you that those are not antitrust issues. I just hope that when people talk about statistics of the cases that we are not bringing, they recognize that those statistics the people are using include a number of these deconcentrating mergers.

With regard to the document request, if after our discussion yesterday your staff was left with the impression that we were refusing to cooperate, I apologize for that because that was not what we were trying to say.

What we are looking for is a way to respond to the Committee as quickly and as fully as we possibly can. I got the letter that you refer to about a week ago. The decision about how to respond to that is something that is really a Department issue and I had to check with various parts of the Department and ultimately a decision about, you know, what is turned over will have to be a Department decision.

I want to cooperate. We have nothing to keep from this Committee. We want to explain to you how we have gone about analyzing these mergers, we want to explain what we have done. We have nothing to hide, but we have to be concerned about our constitutional interests and we also have to be concerned about the time it takes to go back to 1980 and dig up some of these records.

But nobody to my knowledge has refused to do anything and we do want to continue to cooperate with you and I think we have developed a good working relationship with your staff and I do not want to see that deteriorate.

Senator METZENBAUM. I am glad to hear you say that and we look forward to hearing further from you on it. I hope you can move rather promptly, because this committee wants to keep its own momentum going.

TWA, under Carl Icahn, is seeking to acquire U.S. Air in a hostile takeover, although I notice in the paper today there may be some reconsideration. Even though Mr. Icahn has purchased about 15 percent of the stock of U.S. Air, he has never filed a pre-merger submission for antitrust review under the Hart-Scott-Rodino Act.

What troubles me is that even though there appears to be a clear violation of the law, the Justice Department has not intervened in the case to say that the filing should be made. The private parties

involved had to fight this issue on their own, even though the government itself is being prevented from conducting an antitrust review. Can you explain to me why the antitrust department is standing on the sidelines?

Mr. RULE. Well, I can tell you that—let me start off by saying that to some extent because this is a matter that is being looked into, I cannot necessarily and I do not think it would be appropriate to discuss this fully right now before the committee, because we are continuing to look at it.

A couple of points are important to make: First, where there is a violation of the Hart-Scott-Rodino Act, we will bring an enforcement action, but I think it is appropriate that the government bring it itself, rather than to intervene in a private action.

Second, under the regulations, the Hart-Scott-Rodino regulations, there is a provision whereby a company that is engaged in a merger that requires regulatory approval submits the necessary application to the relevant regulatory body—in this case DOT—then it has an exemption from the requirements of the Hart-Scott-Rodino Act.

Now, there are some special circumstances here, we are looking at those, but we have to be very careful that when we bring actions that in fact there are violations of the law, but if there are violations of the law we will take appropriate action.

Senator METZENBAUM. Well, what concerns me as the matter continues to roll on is that the Department of Transportation has dismissed the application, U.S. Air is in court, and I think we are all realists and know enough to know that ex post facto actions really quite often do not serve the purpose.

The Hart-Scott-Rodino notification has a specific purpose in the law. If you are not going to enforce it by not taking any action against what would appear to be a violation of that Act, then I think the American people are entitled to know. Those of us who are particularly concerned about it are entitled to have the facts or the reason for your judgment, and I think that if nothing else, let my comment to you at this moment be an indication that I do not think you can afford the luxury of time because too often it becomes a fait accompli before you have done anything at all.

Mr. RULE. If I might just respond, I appreciate that but I think that also the committee would not appreciate precipitous action by the Department if we did not believe there was not at least reason to believe a violation had occurred.

For example, I understand—I do not know the facts, but it is reported that on Monday, Mr. Icahn and TWA filed a perfected application with DOT which could very well have some effect here.

Senator METZENBAUM. What kind of application?

Mr. RULE. A perfected application. What happened was his original 408 application was rejected on Friday. I understand he then refiled his application on Monday and I am told—again, I do not know this, but there are reports that it is an adequate, sufficient application with DOT. Again, that is a factor that has to be looked at. So it is not as if we are ignoring this, it is not as if we are dragging our heels. We simply want to act in this case as we try to act in all cases, and that is responsibly.

Senator METZENBAUM. Just do not let the horse out of the barn.

Section 7 of the Clayton Act, the principal provision of the law barring harmful mergers, says a merger is illegal if the effect "may be substantially to lessen competition."

Your testimony on page 1 says, "There is no reason for the government to second-guess a merger" unless there is a "substantial probability that the merger will result in the creation of market power."

This is the standard that the administration recommended last year, but Congress did not adopt it. Under what circumstances do you have the right to rewrite the law without congressional action?

Mr. RULE. I do not think we have the right to rewrite the law without congressional action. I think what my testimony was attempting to do was explain or state what has developed as the judicial standard that is applied under section 7. The language under section 7 is rather broad and acceptable potentially to a number of different interpretations.

The reason the administration primarily has recommended the Merger Modernization Act is not so much to change the law, in fact, I would say that that part of it is not designed to change the law. It is rather to codify and clarify what the current state of the law is so as to make it clear to firms, to make it clear to all the courts, and to make it clear in the future that the standard will not change, because that seems to me to be where the standard is that the courts are looking at.

Now, there is language in the *Waste Management* case in the Second Circuit that requires actual future anticompetitive effects and I think that is almost a direct quote from that case, so even though the statutory language says that, the interpretation of that by the courts I think has evolved to the standard that is stated in my statement, and also frankly what is in the Merger Modernization Act.

Senator METZENBAUM. Well, I think we are in disagreement on that, but let me say that we do recognize that we have what we hope will continue to be a cooperative working relationship with your department. We would urge you to enforce the law as it is and recognize your right to press Congress to change the law; and, secondly, we would urge you to act with dispatch when it appears that that is the only way to act if you are to be effective.

Senator Humphrey, do you have any questions?

Senator HUMPHREY. No. Thank you.

Senator METZENBAUM. Thank you very much, Mr. Rule.

Mr. RULE. Thank you, Mr. Chairman.

Senator METZENBAUM. Our next panel consists of Mr. Robert Abrams, Attorney General of New York, and Mr. Anthony J. Celebrezze, Jr., my own Attorney General of the State of Ohio.

We are very happy to welcome both of you and I want to commend you for continued bipartisan support for antitrust and particularly to commend you for the action which you took recently, unanimously as I read the story in the newspaper, indicating that where the Federal Government is not moving in and taking necessary action in connection with antitrust enforcement, whether they do or they do not, the Attorneys General are strongly in favor of effective antitrust enforcement at the state level, whether or not it is forthcoming from the Federal level.

You may want to elaborate. I am not sure I accurately described your action, but it read well to me and I am happy to welcome you, Mr. Abrams.

A PANEL CONSISTING OF: ROBERT ABRAMS, ATTORNEY GENERAL, STATE OF NEW YORK, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, ACCOMPANIED BY LLOYD CONSTANTINE, ASSISTANT ATTORNEY GENERAL FOR ANTITRUST; AND ANTHONY J. CELEBREZZE, JR., ATTORNEY GENERAL, STATE OF OHIO, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Mr. ABRAMS. Chairman Metzenbaum, Senator Metzenbaum, Senator Humphrey, Attorney General Celebrezze and I are delighted to be before you today, representing the National Association of Attorneys General.

Seated to my left is Lloyd Constantine, Assistant Attorney General in charge of Antitrust in New York State, and who chairs a multi-state task force involving antitrust issues of the National Association of Attorneys General.

Senator METZENBAUM. We welcome all of you.

Mr. ABRAMS. Thank you, Mr. Chairman, for this opportunity to address important issues of enforcement of the antitrust laws as they concern mergers and acquisitions.

During the last 6 years, the Federal antitrust enforcement agencies have substantially retreated from a policy of vigorous enforcement of the Sherman and Clayton Acts, which had been a constant during the Republican and Democratic administrations during the last century.

Reduction in enforcement has been exacerbated by Federal attempts to prevent both State Attorneys General and private parties from enforcing the law in accordance with its clear meaning and Supreme Court interpretations.

The withdrawal from traditional enforcement has been particularly pronounced in the area of mergers. Contrasting 1985, which is the last year for which complete statistics are available with 1980, there were roughly twice as many Hart-Scott-Rodino filings, one measure of the business community's recognition of a permissive enforcement climate in Washington.

Although filings have doubled, the number of enforcement actions was less than half, yielding an enforcement ratio of only one-quarter of the earlier period. The number of mergers and the relative absence of enforcement actions do not adequately portray the total picture of the unrestrained wave of mega mergers which have been permitted and encouraged.

The 18 largest corporate mergers in our Nation's history all took place in the period of 1981 to 1986. Federal agencies have also tried to prevent others from enforcing the law now and in the future. The FTC, reversing its previous position, denied State Attorneys General access to pre-merger filings under the Hart-Scott-Rodino Act.

In the Texaco-Getty merger, the comments of twenty-two Attorneys General to the FTC were apparently ignored, and when Attorney General John Van de Kamp of California instituted his own

action to prevent the merger, the FTC asserted that its action or inaction in relation to that merger preempted State action.

The Federal authorities have also asserted the position that neither takeover targets nor competitors of merging firms should have standing to challenge anti-competitive mergers.

State Attorneys General of this country have now responded. During the last several years, the States have become much more active in mergers than in any previous period in history. For State Attorney General enforcement to be effective, predictable and fair to the business community, it must be consistent from State to State.

And so as a result, on March 8, just 3 days ago, the National Association of Attorneys General culminated a year-long effort by unanimously adopting horizontal merger guidelines. These guidelines represent a superior framework for the analysis of the competitive consequences of mergers and the dynamic conditions in an industry.

Among the major differences between the NAAG guidelines and those of the Department of Justice are several which I will briefly describe.

First, the market definition principles adopted by NAAG define both product and geographic markets upon the basis of market realities and from the perspective of those interests the antitrust laws were enacted to protect, namely, the consumers who buy products and services from the merging firms and from their competitors. The DOG guidelines adopt a process of market definition which systematically understates the market share of the merging firms and thereby distorts the competitive consequences of a merger.

Second, the NAAG guidelines properly factor in provable efficiencies which will be achieved through merger. The guidelines clearly provide that if highly probative evidence is produced which shows that specified cost savings will result from a merger, then a challenge is unlikely. The DOJ guidelines invite speculation about efficiencies and effectively permit efficiencies to be used as a defense to an illegal merger in defiance of settled Supreme Court precedent.

The third major contrast concerns the hard evidence standard adopted throughout the NAAG guidelines. Whether the concern is alleged efficiencies which may result from a merger or sources of potential competition which may prevent the abusive exercise of market power, NAAG requires "hard evidence" rather than the mere speculation which the Justice Department invites.

One major purpose of section 7 was to prevent anticompetitive effects in their "incipiency" and to prevent trends toward harmful concentration in an industry. The NAAG guidelines provide for measuring a trend toward concentration in the market during the previous 36 months.

We have all witnessed small innovative companies become major competitive forces in a relatively short time period. It is highly anti-competitive when a leading firm acquires such a small company, thereby buying off future competition. One can think of an IBM picking off an Apple in its infancy and depriving consumers of vigorous competition in the markets for personal and home com-

puters. The NAAG guidelines, unlike DOJ's, recognize this potential problem and effectively deal with it.

A sixth difference in the two sets of guidelines is the treatment of the issue of entry into the market.

Mr. Chairman, I will sum up and conclude now. I request that the full text of my remarks be submitted in the record.

Senator METZENBAUM. It will be included in the record, yes.

Mr. ABRAMS. I also request that the guidelines that were of the National Association of Attorneys General be placed in the record. It is our hope that our perspective, our analysis of what has happened in recent years and our intention to work collaboratively and collegially together in the days ahead will add to the competitive vigor of the marketplace.

We appreciate very much the opportunity that you as the Chairman of this Committee have given us to air our very strongly held views.

Thank you.

[The aforementioned material follows:]

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STATEMENT OF

ROBERT ABRAMS
ATTORNEY GENERAL NEW YORK STATE
VICE-PRESIDENT AND ANTITRUST CHAIRMAN
NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Chairman Metzenbaum and members of the Subcommittee. Thank you for this opportunity to address you concerning the important issue of enforcement of the antitrust laws as they concern mergers and acquisitions.

The National Association of Attorneys General, which I serve as Vice-President and Chairman of the Antitrust Committee, this week unanimously adopted Horizontal Merger Guidelines which will provide a uniform framework for the state attorneys general to enforce the laws in this area. I am here to tell you why the state attorneys general of this country, Republican and Democratic, took this major and historic initiative and to summarize the substance of these Guidelines, copies of which have been provided to the Subcommittee and which I request be made part of the record of these hearings.

As you know, during the last six years, the federal antitrust enforcement agencies have substantially retreated from a policy of vigorous enforcement of the Sherman and Clayton Acts which had been a constant during Republican and Democratic administrations during the last century. The reduction in enforcement has been exacerbated by federal attempts to prevent both state attorneys general and private parties from enforcing the law in accordance with its clear meaning and Supreme Court interpretations.

Although the federal assault on antitrust has been comprehensive, it has been particularly withering in certain areas of traditional enforcement. Two of these areas are

vertical price fixing and other vertical restraints of trade and the law concerning potentially anticompetitive corporate mergers.

Last year the Congress and NAAG both addressed the issue of vertical restraints. NAAG unanimously adopted Vertical Restraints Guidelines to bring uniformity to state attorney general enforcement of the law and to provide a needed antidote to the Justice Department's Vertical Restraints Guidelines, which seriously misstate the law in an area where there has not been a single federal case since the fall of 1980. Following the adoption of our Guidelines, the states brought several major vertical cases, including the coordinated filing of thirty-seven state lawsuits against the Minolta Corporation, charging them with resale price maintenance.

Congress, for its part, concurrently resolved that the Justice Department Guidelines misstated the law and were neither "binding nor persuasive." Congress also continued a funding restriction aimed at preventing the federal agencies from continuing their attack on the rule of per se illegality for resale price maintenance agreements.

In the area of mergers, the federal anti-enforcement policy has been even more aggressive and destructive.

Contrasting 1985 (the last year for which complete statistics are available) with 1980, there were roughly twice as many Hart-Scott-Rodino filings, one measure of the business community's recognition of a permissive enforcement climate in Washington. Although filings have doubled, the number of enforcement actions was less than half, yielding an enforcement ratio of only one quarter of the earlier period. The number of mergers and the relative absence of enforcement actions do not adequately portray the total picture of the unrestrained wave of mega-mergers which has been permitted and encouraged. The eighteen largest corporate mergers in our country's history all took place in the period 1981 to 1986. While the merits of particular transactions can be debated, in the aggregate, the merger wave has seriously increased the level of industrial concentration in our nation and reduced competition.

The federal agencies have also tried to prevent others from

enforcing the law now and in the future. The Federal Trade Commission, reversing its previous position, denied state attorneys general access to pre-merger filings under the Hart-Scott-Rodino Act, lest these law enforcement officials endowed with both statutory and common law parens patriae authority to enforce the federal antitrust laws, use these documents to bring their own merger actions.

In the Texaco-Getty merger the comments of twenty-two Attorneys General to the F.T.C. were apparently ignored and when Attorney General John Van de Kamp of California instituted his own action to prevent the merger, the F.T.C. asserted that its action (or inaction) in relation to that merger pre-empted state action.

The federal authorities have also asserted the position that neither takeover targets nor competitors of merging firms should have standing to challenge anti-competitive mergers.

Finally, in an attempt to prevent future administrations from resuming traditional vigorous enforcement in this area, the federal authorities have proposed the so-called "Merger Modernization Act" which would amend Section 7 to conform it to the Department of Justices' current interpretation of the law, which is that Section 7 does not provide additional authority beyond that in Sherman Act Section 1. Therefore, adoption of the Administration's proposal would effectively abolish Section 7.

The state attorneys general of this country have now responded. During the last several years the states have become much more active in mergers than in any previous period in our history. Pennsylvania instituted a successful action in the Associated Dry Goods May Department Stores merger. Texas brought several successful actions in the soft-drink industry. The California suit in Texaco-Getty continues. A coalition of attorneys general helped block the highly anticompetitive proposed acquisition of Conrail by Norfolk-Southern and my office coordinated with Massachusetts on actions concerning several mergers in the airline industry. For state attorney general enforcement to be effective, predictable and fair to the business

community it must be consistent from state to state. Therefore, on March 8, NAAG's members culminated a year long effort by unanimously adopting Horizontal Merger Guidelines. These Guidelines represent a superior framework for the analysis of the competitive consequences of mergers and the dynamic conditions in an industry and are grounded in the realities of the marketplace, widely accepted economic theory and, most importantly, in the letter and spirit of Section 7 and its interpretation by the United States Supreme Court.

Among the major differences between the NAAG Guidelines and those of the Department of Justice, are seven which I will briefly describe.

First, the market definition principles adopted by NAAG define both product and geographic markets upon the basis of market realities and from the perspective of those interests the antitrust laws were enacted to protect, the consumers who buy from the merging firms and their competitors. The D.O.J. Guidelines adopt a process of market definition which systematically understates the market share of the merging firms and thereby distorts the competitive consequences of a merger. Even those who find the Justice Department's mathematical projections theoretically sound, admit that they cannot actually be performed.

Second, the NAAG Guidelines properly factor in provable efficiencies which will be achieved through merger. The Guidelines clearly provide that if highly probative evidence is produced which shows that <u>specified</u> cost savings will result from a merger, then a challenge is unlikely.

However, since both Congress and the Supreme Court has foreclosed any balancing of alleged efficiencies when an otherwise highly anticompetitive merger is proposed, the NAAG Guidelines only consider efficiencies to be a mitigating factor in the HHI range of 1000-1800. The D.O.J. Guidelines invite speculation about efficiencies and effectively permit

efficiencies to be used as a defense to an illegal merger in defiance of settled Supreme Court precedent.

The third major contrast concerns the hard evidence standard adopted throughout the NAAG Guidelines. Whether the concern is alleged efficiencies which may result from a merger or sources of potential competition which may prevent the abusive exercise of market power, NAAG requires "hard evidence" rather than the mere speculation which the Justice Department invites.

One major purpose of Section 7 was to prevent anti-competitive effects in their "incipiency" and to prevent trends toward harmful concentration in an industry. While the D.O.J. Guidelines treat each merger discretely without substantial consideration of other recent merger activity in that industry, the NAAG Guidelines provide for measuring a trend toward concentration in the market during the previous 36 months.

We have all witnessed small innovative companies become major competitive forces in a relatively short time period. It is highly anticompetitive when a leading firm acquires such a small company, thereby buying off future competition. One can think of an I.B.M. picking off an Apple in its infancy and depriving consumers of vigorous competition in the markets for personal and home computers. The NAAG Guidelines, unlike D.O.J.'s recognize this potential problem and effectively deal with it.

A sixth difference in the two sets of Guidelines is the treatment of the issue of entry into the market. Both recognize that if entry is easy, then any attempted exercise of market power is likely to be disciplined by the added competition of new entrants. To make an otherwise "likely" challenge to a merger "unlikely," entry must be possible within one year under the NAAG Guidelines. The Department of Justice is willing to let consumers wait two years for market forces to provide relief.

The last major contrast concerns the factors beyond market share and concentration which will be assessed in determining whether a merger is likely to substantially lessen competition. NAAG will examine three additional factors. They are, ease of entry, past or current collusive behavior in the industry and

efficiencies. The weight of these factors and when they are applied are clearly specified.

The Department of Justice will assess thirteen unweighted factors. While it is clear that each of these factors may be said to effect the competitive consequences of a merger, in fact, the sheer number and normless application of these factors might render enforcement under the guidelines highly subjective and unpredictable.

In fact, the real harm of these factors is that they are used as rationalizations for not challenging mergers which are probably anticompetitive under the relatively objective tests of market share and market concentration measured by the HHI and still relied upon in most court decisions. The federal authorities have in fact used these additional factors to avoid challenges to mergers which should have been challenged even under their otherwise permissive guidelines.

In each area which I have outlined we believe that the NAAG Guidelines provide a superior, simple, predictable and reasoned basis for analysis. Each is also grounded in the actual purpose and meaning of the law.

I will be happy to attempt to answer any questions you might have.

ANTITRUST ENFORCEMENT:

HORIZONTAL MERGER GUIDELINES OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

March 10, 1987

Washington, D.C.

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Steve Clark
Attorney General of Arkansas
President

Washington, D.C.
March 10, 1987

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1. PURPOSE AND SCOPE OF THE GUIDELINES

These Guidelines explain the general enforcement policy of the fifty-five state and territorial attorneys general ("the Attorneys General") who comprise the National Association of Attorneys General[1] ("NAAG") concerning horizontal[2] acquisitions and mergers (mergers) subject to section 7 of the Clayton Act,[3] sections 1 and 2 of the Sherman Act[4] and analagous provisions of the antitrust laws of those states which have enacted them.[5]

The state attorney general is the primary or exclusive public enforcer of the antitrust law in most states. The Attorneys General also represent their states and the natural person citizens of their states in federal antitrust ligitation.[6]

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1. The Attorneys General of American Samoa, Guam, The Commonwealth of Northern Mariana Islands, The Commonwealth of Puerto Rico and the Virgin Islands are members of NAAG.

2. A horizontal merger involves firms that are actually or potentially in both the same product and geographic markets, as those markets are defined in Section 3 of these Guidelines.

3. Section 7 of the Clayton Act, 15 U.S.C. § 18 prohibits mergers if their effect "may be substantially to lessen competition or to tend to create a monopoly."

4. Section 1 of the Sherman Act 15 U.S.C. § 1 prohibits mergers which constitute an unreasonable "restraint of trade." Section 2 of the Sherman Act, 15 U.S.C. §2 prohibits mergers which create a monopoly or constitute an attempt, combination or conspiracy to monopolize.

5. Citations to the antitrust laws of the States are set forth in Appendix A.

6. The authority of the Attorneys General to invoke section 7 of the Clayton Act to enjoin a merger injuricus to the general welfare and economy of the State is confirmed in Georgia v. Pennsylvania Railroad Co., 324 U.S. 439 (1945).

These Guidelines embody the general enforcement policy of NAAG and its members. Individual attorneys general may vary or supplement this general policy in recognition of variations in precedents among the federal circuits and differences in state antitrust laws and in the exercise of their individual prosecutorial discretion.

These Guidelines serve three primary purposes. First, they provide a uniform framework for the states to evaluate the facts of a particular horizontal merger and the dynamic conditions of an industry. Second, they inform the business community of the substantive standards used by the Attorneys General to review, and when appropriate, challenge specific mergers. This will allow the business community to assess potential transactions under these standards and therefore be useful as a risk assessment and business planning tool. Third, the Guidelines put forward a framework for the analysis of horizontal mergers which relies upon market realities and which is grounded in and consistent with the purposes and meaning of section 7 of the Clayton Act, as amended by the Celler-Kefauver Act of 1950 ("section 7"), and as reflected in its clear legislative history and consistent interpretation by the United States Supreme Court.[7]

7. This orientation recognizes a basic principle which should properly guide governmental enforcement of the law. It is the legislative function to make basic policy choices, whether or not these choices coincide with the beliefs of a particular administration, enforcement agency, or a particular school of economic theory.

The organizing principle of the Guidelines is the application of facts concerning the marketplace and widely accepted economic theory to these authoritative sources of the law's meaning.

2. POLICIES UNDERLYING THESE GUIDELINES

The federal antitrust law provisions relevant to horizontal mergers, most specifically section 7 and analagous state law provisions,[8] have one primary and several subsidiary purposes. The central purpose of the law is to prevent firms from attaining market or monopoly power,[9] because firms possessing such power can raise prices to consumers above competitive levels, thereby effecting a transfer of wealth from consumers to such firms.[10]

8. For example, see statutes of Hawaii, Maine, Mississippi, Nebraska, New Jersey, Ohio, Oklahoma, Texas, Washington and Puerto Rico for provisions analagous to section 7. Appendix B contains citations to state anti-merger provisions. However, all states with a provision analagous to Sherman Act §1 may also challenge mergers under such authority. See note 6 concerning state enforcement of Section 7.

9. Market power is the ability of one or more firms to maintain prices above a competitive level, or to prevent prices from decreasing to a lower competitive level, for a significant period of time.

10. A buyer or group of buyers may similarly attain and exercise the power to drive prices below a competitive level for a significant period of time. This is usually termed an exercise of "monopsony power." When the terms "buyer(s)" or "groups of buyers" are used herein they are deemed to include "seller(s)" or "groups of sellers" adversely affected by the exercise of market or monopsony power.

Congress determined that highly concentrated industries were characterized by and conducive to the exercise of market power and prohibited mergers which may substantially lessen competition. Such mergers were prohibited even prior to the actual attainment or exercise of market power, that is, when the trend to harmful concentration was incipient.

Other goals of the law were the prevention of excessive levels of industrial concentration because of the political and social effects of concentrated economic power and the fostering of productive efficiency, organizational diversity, technological innovation and the maintenance of opportunities for small and regional businesses to compete.[11]

Goals such as productive efficiency, though subsidiary to the central goal of preventing wealth transfers from consumers to firms possessing market power, are often consistent with this primary purpose. When the productive efficiency of a firm increases, (its cost of production is lowered) the firm may pass on some of the savings to consumers in the form of lower prices. However, there is little likelihood that a productively efficient firm with market power would pass along savings to consumers.

11. Brown Shoe Co. v. United States, 370 U.S. 294, 315-16 (1962).

To the limited extent that Congress was concerned with productive efficiency in enacting these laws, it prescribed the prevention of high levels of market concentration as the means to this end.[12] Furthermore, the Supreme Court has clearly ruled that any conflict between the goal of preventing anticompetitive mergers and that of increasing efficiency must be resolved in favor of the former explicit and predominant concern of the Congress.[13]

12. There is vigorous debate whether firms in industries with high concentration are on average more or less efficient than those in industries with moderate or low levels of concentration.

The theory of "x-inefficiency" predicts that firms constrained by vigorous competition have lower production costs than firms in an industry with little or no competition. Various economists have attempted to quantify production cost increases due to x-inefficiency and the theory is the subject of ongoing debate.

Regardless of such debate, Congress had the prerogative to make a choice, opting for less concentration, and did so with little regard for efficiency. The primary concern was wealth transfers from consumers to firms exercising market power.

13. In FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967), the Court stated:

> Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.

In United States v. Philadelphia National Bank, 374 U.S. 321, 371 (1963), the Court stated:

> We are clear, however, that a merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.

The Congress evidenced little or no concern for allocative efficiency when it enacted section 7 and the other antitrust laws.[14] Nevertheless, preserving allocative efficiency is generally considered an additional benefit realized by the prevention of market power, because the misallocative act of restricting output has the concomitant effect of raising prices to consumers. It is counterintuitive, however, to primarily base merger policy on the analysis of these efficiency effects, which are inconsequential in the statutory scheme, and are insignificant in relation to the wealth transfers associated with the exercise of market power.[15]

14. Perfect "allocative efficiency" or "Pareto optimality" is a state of equilibrium on the so-called "utility-possibility frontier" in which no person can be made better off without making someone else worse off. Allocative efficiency can be achieved in an economy with massive inequalities of income and distribution, e.g., 1% of the population can receive 99% of the economy's wealth and 99% of the population can receive 1%. A massive transfer of wealth from consumers to a monopolist does not of itself decrease allocative efficiency. However, when a monopolist restricts its output, the total wealth of society is diminished, thereby reducing allocative efficiency. Economists term this loss of society's wealth the "deadweight loss."

15. In most mergers creating market power, the effect of the wealth transfer from consumers will be many times as great quantitatively as the effect on allocative efficiency (dead weight loss). See note 14. It is important to re-emphasize that wealth transfer is irrelevant to the issue of allocative efficiency. The term of art "consumer welfare," often used when discussing the efficiency effects of mergers and restraints of trade, refers to the concept of allocative efficiency. A transfer of wealth from consumers to firms with market power does not diminish "consumer welfare." For the unwary Judge or practitioner stumbling upon this term it is important to understand this fact and to further understand that "consumer welfare", when used in this manner, has nothing to do with the welfare of consumers.

2.1 THE COMPETITIVE EFFECTS OF MERGERS

Mergers may have negative or positive competitive consequences. The following is a summary description of the most common competitive effects of mergers relevant to enforcement of section 7.[16]

2.11 ACQUISITION OF MARKET POWER AND WEALTH TRANSFERS

When two firms, neither possessing market power, cease competing and merge, the inevitable consequence is the elimination of the competition between them. More significantly, however, the merged entity may now possess market power, an unambiguously anticompetitive outcome.

A merger may also increase the concentration level in an industry to a point at which the few remaining firms can effectively engage in active collusion or implicitly coordinate their actions and thus collectively exercise market power.

When a firm or firms exercise market power by profitably maintaining prices above competitive levels for a significant period of time, a transfer of wealth from consumers to those

16. These Guidelines deal only with these competitive consequences of horizontal mergers. Mergers may have many other consequences, beneficial or detrimental, not relevant to the enforcement of section 7. The penalization of ineffective management and the distortion of cash flow and capital flow patterns are two frequent results of mergers not substantially related to the purposes of section 7. More important, mergers may also have other consequences that are relevant to the objectives of section 7. These implicate concerns that are primarily social and political in nature, such as the effect upon opportunities for small and regional businesses to survive and compete. These consequences are especially significant in the analysis of conglomerate mergers, which are beyond the scope of these Guidelines.

firms occurs.[17] This transfer of wealth is the major evil sought to be addressed by section 7.[18]

The wealth transfer orientation of section 7 is the same as that of the Sherman Act. The major difference and reason for the enactment of section 7 of the Clayton Act was the "incipiency" standard, which permits antitrust intervention at a point when the anticompetitive consequences of a merger are not manifest but are likely to occur absent intervention. The Celler-Kefauver amendments retained and strengthened the "incipiency" standard by extending the coverage of the law to acquisitions of assets. In Section 4 of these Guidelines the Attorneys General specifically attempt to give expression to the statutory concern of "incipiency."

2.12 PRODUCTIVE EFFICIENCY

A merger may increase or decrease the costs of the parties to the merger and thus increase or decrease productive efficiency. A merger which increases productive efficiency and does not produce a firm or firms capable of exercising market

17. Tacit or active collusion on terms of trade other than price also produces wealth transfer effects. This would include, for example, an agreement to eliminate rivalry on service features or to limit the choices otherwise available to consumers.

18. The predominant concern with wealth transfers was evidenced in the statements of both supporters and opponents of the Celler-Kefauver amendments. See, e.g., 95 Cong. Rec. 11,506 (1949) (remarks of Rep. Bennett); Id. at 11,492 (remarks of Rep. Carroll); Id. at 11,506, (remarks of Rep. Byrne); Hearings before the Subcomm. on the Judiciary, 81st Cong., 1st and 2d Sess., note 260, at 180 (remarks of Sen. Kilgore); 95 Cong. Rec. 11,493 (1949)(remarks of Rep. Yates); Id. at 11,490-91 (remarks of Rep. Goodwin); 95 Cong. Rec. 16,490 (1949) (colloquy of Sen. Kefauver and Sen. Wiley).

power should lower prices paid by consumers. An inefficient merger in an unconcentrated industry is generally of no competitive concern. The efficiency effects of mergers are easy to speculate about but hard to accurately predict. There is much disagreement among economists as to whether merged firms usually perform well and whether, on average, mergers have been shown to produce significant efficiencies. However, most efficiencies and those most quantitatively significant will be realized in mergers involving small firms. Such mergers do not raise any concern under the enforcement standards adopted in Section 4 of these Guidelines. Furthermore, the concentration thresholds adopted in Section 4 are more than high enough to enable firms to obtain the most significant efficiences likely to result from growth through merger as opposed to growth through internal expansion.

2.13 ALLOCATIVE EFFICIENCY

A merger which facilitates the exercise of market power results in a decrease in allocative efficiency. When firms with market power restrict their output, the total wealth of society diminishes. This effect is universally condemned by economists, and its prevention, while not a significant concern of the Congress which enacted section 7, is a goal consistent with the purposes of the antitrust laws.

2.14 RAISING RIVALS' COSTS

In certain circumstances a merger may raise the costs of the competitors of the parties to the merger. For example, a merger could increase the power of a firm to effect the price that rivals must pay for inputs or the conditions under which they must operate, in a manner that creates a relative disadvantage for the rivals. If the market structure is such that these increased costs will be passed on to consumers, then the prevention of this effect is consistent with the goals of the antitrust laws. Preventing such effect will also prevent a decrease in allocative efficiency.

3. MARKET DEFINITION

These Guidelines are concerned with horizontal mergers, that is, mergers involving firms that are actual or potential competitors in the same product and geographic markets.

The primary analytical tool utilized in the Guidelines is the measurement of concentration in a particular market and increase in concentration in that market resulting from a merger. The market shares used to compute these concentration factors will depend upon the market definition adopted.[19] The reasonable

19. For example, consider the proposed merger of two firms producing the same product. Each has a 50% share of the sales of this product in a certain state but only 1% of national sales. If the proper geographic market is the state, then the competitive consequences of the merger will be far different than if the geographic market is the entire country.

delineation of these market boundaries is critical to realizing the objectives of the Guidelines and the antitrust laws. If the market boundaries chosen are seriously distorted in relation to the actual workings of the marketplace, an enforcement error is likely.[20] An overly restricted product or geographic market definition may trigger antitrust intervention when the merger would not significantly harm competition or in other circumstances result in the failure to challenge an anticompetitive merger. An overly expansive market definition also may result in the failure to challenge a merger with serious anticompetitive consequences.[21] Markets should be defined from the perspective of those interests section 7 was primarily

20. Governmental challenge of a merger which is not likely to lessen competition substantially is frequently termed "Type I error." The failure to challenge a merger which is likely to lessen competition substantially is termed "Type II error." Type I error should be corrected by the Court which determines the validity of the challenge. Type II error will most likely go uncorrected, since the vast majority of merger challenges are mounted by the government. In other areas of antitrust law, private actions predominate and can correct type II error. Consumers, whose interests were paramount in the enactment of section 7 and section 1 of the Sherman Act, suffer the damage of type II error.

21. Consider, for example, the market(s) for flexible wrapping materials. These materials include clear plastic, metallic foils, waxed paper and others. Firms A and B each produce 30% of the clear plastic wrap and 5% of all flexible wrapping material in a relevant geographic market. Firm C produces 70% of the metallic foil and 60% of all flexible wrap. If the proper market definition is all flexible wrapping materials, then treating clear plastic and metallic foils as separate markets may lead to an unwarranted challenge to a merger between firms A and B. The same incorrect market definition may also result in the failure to challenge a merger between Firm C and either Firm A or Firm B because of the incorrect assumption that metallic foil and clear plastic wrap do not compete. However, if the correct market definition is clear plastic wrap but the more expansive market definition of all flexible materials is chosen, this may result in the failure to challenge an anticompetitive merger of firms A and B.

enacted to protect, i.e., the classes of consumers (or suppliers) who may be adversely affected by an anticompetitive merger. The Attorneys General will utilize historical data to identify these classes of consumers ("the protected interest group") their sources of supply, suitable substitutes for the product and alternative sources of the product and its substitutes. The market thus defined will be presumed correct unless rebutted by hard evidence that supply responses within a reasonable period of time will render unprofitable an attempted exercise of market power.[22]

The following sections detail how these general principles will be applied to define product and geographic markets and to calculate the market shares of firms determined to be within the relevant market.

3.1 PRODUCT MARKET DEFINITION

The Attorneys General will determine the customers who purchase the products or services ("products") of the merging firms. Each product produced in common by the merging parties will constitute a provisional product market. The provisional product market will be expanded to include suitable substitutes

22. Hard evidence, as contrasted with speculation, is generally grounded in historical fact. Hard evidence of a probable supply response would include a factual showing that this response had occurred in the past when prices increased significantly. A mere prediction that a manufacturer will shift his production from one product to another to capitalize on a price increase, when unsupported by evidence of a previous similar response or other information of similarly probative nature, is not considered "hard evidence."

for the product which are comparably priced.[23] A comparably priced substitute will be deemed suitable and thereby expand the product market definition if, and only if, considered suitable by at least 75% of these customers.

Actual substitution by customers in the past will presumptively establish that a product is considered a suitable substitute for the provisionally defined product, however, other evidence probative of the assertion that customers deem a product to be a suitable substitute offered by the parties to the merger will also be considered.[24]

23. The existence of a functionally suitable substitute which is significantly more expensive than the relevant product will not discipline an exercise of market power until the price of the relevant product has been raised to a level comparable to the substitute. The Attorneys General will also seek to ascertain whether current price comparability of two products resulted from an exercise of market power. For example, suppose that the provisionally defined product recently cost 20% less than a possible substitute, but its price has recently risen 20% as a result of the exercise of market power. Rather than serving as a basis for broadening the product market to include the possible substitute, this finding will provide compelling evidence that any further concentration through merger will only exacerbate the market power which already exists. To ascertain whether the price comparability of two possibly interchangeable products was the result of an exercise of market power over one product, the appropriate question to ask may be "what would happen if the price of the product in question dropped?" If a significant price decrease does not substantially increase sales, then a previous exercise of market power has likely been detected, and the two products should probably be considered to be in separate product markets. See, United States v. E.I. duPont de Nemours & Co., 351 U.S. 377, 399-400 (1956).

24. Recycled or reconditioned goods will be considered suitable substitutes if they meet the requirements of this Section.

3.11 PRODUCT SUBMARKETS

Notwithstanding the determination in Section 3.1 that a product is a suitable substitute for the provisional product pursuant to application of the 75% rule, there may be small but significant groups of consumers who cannot substitute or can do so only with great difficulty. These consumers may be subject to price discrimination and be particularly adversely affected by a merger. In such instances, the Attorneys General may define additional narrower product submarkets.

Evidence of the commercial reality of such a submarket includes price discrimination, inelasticity of demand and industry or public recognition of a distinct submarket.

3.2 GEOGRAPHIC MARKET DEFINITION

Utilizing the product market(s) defined in Section 3.1, the Attorneys General will define the relevant geographic market.

First, the Attorneys General will determine the sources and locations where the customers of the merging parties readily turn for their supply of the relevant product. These will include the merging parties and other sources of supply. To this group of suppliers and their locations will be added suppliers of buyers closely proximate to the customers of the merging parties. In determining those suppliers to whom the protected interest group readily turn for supply of the relevant product, the Attorneys General will include all sources of supply within the past two years still present in the market.

Utilizing the locations from which supplies of the relevant product are obtained by members of the protected interest group, the geographic market will be defined as the area encompassing the production locations from which this group purchases 75% of their supplies of the relevant product.

The product and geographic markets as defined above will be utilized in calculating market shares and concentration levels unless additional sources of supply are recognized by application of the procedures specified in Section 3.3.

3.22 GEOGRAPHIC SUBMARKETS

The Attorneys General may define additional narrower geographic markets when there is strong evidence that sellers are able to discriminate among buyers in separate locations within the geographic market(s) defined in Section 3.2. The Attorneys General will evaluate evidence concerning discrimination on price, terms of credit and delivery and priority of shipment.[25]

3.3 PRINCIPLES FOR RECOGNIZING POTENTIAL COMPETITION

The firms identified as being in the markets defined by the procedures outlined in Sections 3.1 and 3.2 will be utilized in calculating market shares and measuring concentration unless the parties to the merger produce relevant hard evidence of profitable supply and demand responses which will be likely to occur within one year of any attempted exercise of market power.

25. The Attorneys General welcome submissions by buyers concerning such discrimination or any other hard evidence that a proposed merger will adversely effect them because it is likely substantially to lessen competition.

When such potential competition is proven to be likely to emerge within a year, the Attorneys General will calculate market shares and concentration levels after incorporating such sources of potential supply.

The Attorneys General will evaluate hard evidence produced by the parties to a merger of the following sources of potential competition:

1) That firms will divert supplies of the product not currently sold in the relevant geographic market into that market.
2) That current suppliers of the product will produce additional supplies for the relevant market by utilizing excess capacity or adding new productive capacity.
3) That new sources of the product will be readily available from firms with production flexibility, firms who will build new capacity and firms engaging in arbitrage.

2.31 DIVERSION OF EXISTING SUPPLIES INTO THE MARKET

The parties to a merger may produce evidence that firms will divert supplies of the product into the market in response to a price increase or restriction of output. The Attorneys General will analyze proof concerning such probable diversions of supplies currently exported from the relevant market, supplies

internally consumed by vertically integrated firms in the market and additional supplies from firms currently shipping part of their production into the market.

3.31A EXPORTS

A firm currently exporting the product from the relevant market may divert the supply back into the market in response to a price increase or restriction of output.

This response is unlikely from an exporter who is a party to the merger, since it is unlikely to discipline its own attempted exercise of market power. It is also unlikely if the exporter is an oligopolist likely to benefit from the collective exercise of market power.

Although parties wishing to prove this supply response are free to produce any hard evidence, the most persuasive proof will be historical shipping patterns showing past diversion of exports in response to price increases or restricted supply. In addition the parties should, at a minimum, address the following questions: Are the exports contractually committed and for what term? Are the exports otherwise obligated to current buyers?

3.31B INTERNAL CONSUMPTION

A vertically integrated firm producing the product for internal consumption may divert this supply to the open market. Diversion is unlikely if there are no suitable and economical substitutes for the product and/or the firm has contractual or other obligations for the goods utilizing the relevant product.

The most persuasive proof of such diversion will be evidence that a vertically integrated firm already sells some of the product on the open market and has a history of transferring production intended for internal consumption to the open market.

3.31C INCREASED IMPORTATION

A firm shipping part of its output of the product into the relevant market may respond to an attempted exercise of market power by diverting additional production into the relevant market. Parties seeking to prove the likelihood of this supply response should, at a minimum, address the factual issues of whether and for what terms these additional supplies are contractually or otherwise obligated to buyers outside the relevant market, the percentage of the suppliers' production now sent into the market and their historical shipping patterns.

3.32 EXPANSION OF OUTPUT

The parties to a merger may produce evidence that current suppliers of the product will expand their output by utilization of excess capacity or the addition of new capacity within one year of any attempted exercise of market power. Parties attempting to prove probable utilization of excess capacity should at a minimum address the issues of (i) the cost of bringing the excess capacity on line; (ii) the amount of excess capacity; (iii) for a firm not currently supplying the relevant market, prior history of supplying this market or present intention to do so; and (iv) how much prices would have to rise to likely induce this supply response.

3.33 NEW PRODUCTION SOURCES OF ADDITIONAL SUPPLY

The parties to a merger may produce evidence that firms not currently supplying the product will do so within one year of any attempted exercise of market power. This might be shown for firms with production flexibility, firms who will erect new production facilities and firms engaging in arbitrage.

3.33A PRODUCTION FLEXIBILITY

The Attorneys General will evaluate proof concerning firms with flexible production facilities who are capable of switching to the production of the relevant product within one year and are likely to do so. A history of such switching in the past will be the most persuasive evidence that this response is probable.

3.33B CONSTRUCTION OF NEW FACILITIES

A party may attempt to demonstrate that firms not presently supplying the product will erect new plant facilities (or establish new service facilities) within one year of an attempted exercise of market power.

3.33C ARBITRAGE

Firms proximate to the relevant market may respond to an exercise of market power by buying the product outside the market and reselling it inside the market. This potential source of supply is unlikely if the relevant product is a service or combined product and service. A history of arbitrage in the industry will be most probative that this potential response is probable.

3.4 CALCULATING MARKET SHARES

Using the product and geographic markets defined in Sections 3.1 and 3.2, the firms supplying the market and any additional sources of supply recognized under Section 3.3, the shares of all firms determined to be in the market will be calculated.

The market shares of firms presently supplying the market shall be based upon actual sales within the relevant market. If there has been a demonstration of a probable supply response as defined in Section 3.3, the market shares of firms already selling in the market will be adjusted to account for the proven probable supply response. Similarly, market shares will be assigned to firms not currently supplying the market who have been shown to be likely to enter the market in response to an attempted exercise of market power. The assigned market shares of such firms will be based upon the amount of the product these firms would supply in response to an attempted exercise of market power. The Attorneys General will utilize dollar sales, unit sales or other appropriate sales measurements to quantify actual sales. Expected dollar or unit sales will be used when proven supply responses have expanded the market definition.

3.41 FOREIGN FIRMS

Foreign firms presently supplying the relevant market will be assigned market shares in the same manner as domestic firms, according to their actual current sales in the relevant market. Foreign firms and their productive capacity are inherently a less reliable check on market power by domestic firms because foreign firms face a variety of barriers to continuing sales or

increasing their sales. These barriers include import quotas, voluntary quantitative restrictions, tariffs and fluctuations in exchange rates. When such barriers exist, market share based upon historical sales data will be reduced.

A single market share will be assigned to the firms of any foreign country or group of countries which in fact coordinate their sales.[26]

4. MEASUREMENT OF CONCENTRATION

The primary tool utilized by the Attorneys General to determine whether a specific horizontal merger is likely to substantially harm competition is a measurement of the level of concentration in each market defined in Section 3. Concentration is a measurement of the number of firms in a market and their market shares. The Guidelines employ the Herfindahl-Hirschman Index ("HHI") to calculate the level of concentration in an industry before and after a merger and, therefore, the increase in concentration which would result from the merger.[27] Basing

26. For example, an import quota may be established for a particular foreign country and the foreign government may then apportion the quota among firms engaged in the import of the relevant product.

27. The HHI is computed by summing the numerical squares of the market shares of all the firms in the market. For example, a market with four firms each having a market share of 25% has an HHI of 2500 calculated as follows: $25^2 + 25^2 + 25^2 + 25^2 = 2500$. A market with a pure monopolist, i.e., a firm with 100% of the market, has an HHI of 10,000 calculated as $100^2 = 10,000$. If the market has four firms, each having a market share of 25% and two of these four firms merge, the increase in the HHI is computed as follows: Pre-merger $25^2 + 25^2 + 25^2 + 25^2 = 2500$. Post-merger $50^2 + 25^2 + 25^2 = 3750$. The increase in the HHI due to the merger is 1250, i.e. 3750 - 2500 = 1250. The increase is also equivalent to twice the product of the market shares of the merging firms, i.e., 25 x 25 x 2 = 1250.

merger policy on measurements of market concentration furthers the goals of both section 7 and these Guidelines.

Unlike the traditional four firm concentration ratio ("CR4") which was formerly used by enforcement agencies and courts to measure market concentration,[28] the HHI reflects both the distribution of the market shares of all the leading firms in the market and the composition of the market beyond the leading firms.[29]

The predominant concern of the Congress in enacting section 7 was the prevention of high levels of industrial concentration because of the likely anticompetitive consequences. Foremost among these likely anticompetitive effects of high concentration is the exercise of market power by one or more firms through monopolization, collusion or interdependent behavior in an oligopolistic market. Section 7 militates that the HHI levels which trigger an action to block a merger be set at the concentration levels likely to prevent these anticompetitive actions and interactions.

28. The CR4 is the sum of the market shares of the top four firms in the market. A CR4 cannot be converted into any single HHI but rather includes a possible range of HHI levels. For example, consider two markets with CR4 of 100%. The first is comprised of 4 firms; each with a market share of 25%. This yields an HHI of 2500, i.e. $25^2 + 25^2 + 25^2 + 25^2 = 2500$. The second market is comprised of four firms with market shares of 70%, 10%, 10% and 10%. This yields an HHI of 5200, i.e., $70^2 + 10^2 + 10^2 + 10^2 = 5200$.

29. The HHI also gives significantly greater weight to the market shares of the largest firms, which properly reflects the leading roles which such firms are likely to play in a collusive agreement or other exercise of market power. A single dominant firm's likely role as the price leader in an oligopolistic market is also reflected in the HHI. For these reasons, the HHI is now the generally preferred measure of concentration.

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The objective of preventing future likely anticompetitive effects should be based primarily upon the historical picture of the market rendered by concentration levels, since industrial and economic concentration were the primary concerns of the framers of section 7. Furthermore, the predominant focus of scholarly economic inquiry into the competitive consequences of mergers has been the correlation of concentration levels with various indicia of competition. Other theories which predict the competitive effects of mergers based upon factors other than market concentration, though valuable, have not nearly reached the level of precision which is necessary for them to form the basis for responsible policy decisions. The facts of recent history are a far more reliable gauge of future consequences than such theories.[30]

The Attorneys General divide the spectrum of market concentration into the same three numerical regions utilized by the United States Department of Justice.[31] They are

30. There may be instances where clear evidence compels the conclusion that concentration levels and market shares inaccurately portray the competitive significance of a particular merger. In accordance with the doctrine of United States v. General Dynamics Corp., 415 U.S. 486 (1974), such situations will require case by case analysis.

31. Although these Guidelines and those of the Department of Justice are generally consistent in their adoption of the HHI thresholds which will likely trigger an enforcement action, the market definition principles employed are different. See Section 3 herein and Section 2 of the Justice Department Guidelines; U.S. Dep't. of Justice, Merger Guidelines (June 14, 1984) reprinted in Antitrust & Trade Reg. Rep. (BNA) No. 1169 (June 14, 1984); Trade Reg. Rep. (CCH) No. 655 at 25 (June 18, 1984). The different market definition principles will often produce differing market shares which are then utilized to calculate the HHI. This is so because the process of market definition in the Justice Department's Guidelines will, in many respects, overstate the bounds of both the geographic and product markets in relation to the actual workings of the marketplace. This will result in the systematic understatement of market shares used in calculating market concentration.

characterized in these Guidelines as "acceptable concentration" (HHI below 1000) "moderate to high concentration" (HHI between 1000 and 1800) and "very high concentration" (HHI above 1800).[32]

4.1 GENERAL STANDARDS

The Attorneys General will calculate the post-merger concentration level in the market and the increase in concentration due to the merger. In certain cases, increases in concentration during the 36 months prior to the merger will also be assessed.

While it may be justifiable to challenge any merger above the threshold of market concentration where collusion and interdependent behavior are significantly facilitated (HHI 1000) the Attorneys General are unlikely to challenge mergers which do not significantly increase concentration. This policy recognizes section 7's prohibition of mergers whose effect "may be substantially to lessen competition." When the threshold of very high concentration is traversed (HHI 1800) the likelihood of anticompetitive effects are greatly increased and the increase in concentration likely to substantially lessen competition concomitantly reduced. The concentration increases which are likely to trigger an enforcement action under these guidelines have been adopted in reasonable accomodation of both

32. The Attorneys General are unlikely to challenge any merger in an industry with a post-merger HHI of less than 1000. An HHI of 1000, the level at which enforcement actions start to become probable under these Guidelines, can be found in a market with ten firms each with a 10% market share. Collusion and/or oligopolistic behavior are plausible in a market comprised of ten or fewer firms of roughly equal size.

the "substantiality" requirement of Section 7 and the need to objectively factor in the dynamic conditions in an industry. The latter concern is addressed by measuring increases in market concentration during the 36 months prior to a merger.

4.2 POST-MERGER HHI BETWEEN 1000 AND 1800

An action to challenge a merger is likely if the merger

a) increases the HHI by more than 100 points or

b) increases the HHI by more than 50 points and during the 36 months prior to the proposed merger the HHI has increased by more than 100 points. Notwithstanding the foregoing, a challenge is unlikely in either case if assessment of the factors discussed in Sections 5.1 and/or 5.3 clearly compel the conclusion that the merger is not likely substantially to lessen competition.

4.3 POST-MERGER HHI ABOVE 1800

An action to challenge a merger is likely if the merger

a) increases the HHI by more than 50 points or

b) increases the HHI by more than 25 points and during the 36 months prior to the proposed merger the HHI has increased by more than 50 points. Notwithstanding the foregoing, a challenge is unlikely in either case if assessment of the factor discussed in Section 5.1 clearly compels the conclusion that the merger is not likely substantially to lessen competition.

4.4 MERGERS INVOLVING THE LEADING FIRM OR A NEW INNOVATIVE FIRM IN A MARKET

The merger of a dominant firm with a small firm in the market may create or increase the market power of the dominant firm yet increase the HHI by an amount less than the levels set forth in Sections 4.2 and 4.3. Similarly, the merger of a new, innovative firm with an existing significant competitor in the market may substantially reduce competition yet increase the HHI by an amount less than the levels set forth in Sections 4.2 and 4.3. Therefore, an action to challenge a merger will also be likely if the proposed merger involves either a leading firm with a market share of at least 35 percent and a firm with a market share of 1 percent or more, or a firm with a market share of 20 percent or more and a new, innovative firm in a market with moderate to high concentration or very high concentration, unless assessment of the factor discussed in Section 5.1 clearly compels the conclusion that the merger is not likely substantially to lessen competition. In addition, in a market with moderate to high concentration the factor discussed in Section 5.3 will also be assessed.

5. ADDITIONAL FACTORS WHICH MAY BE CONSIDERED IN DETERMINING WHETHER TO CHALLENGE A MERGER

There are numerous factors aside from market share and market concentration which may make a merger more or less likely substantially to lessen competition. While the assessment of most or many of these factors would increase the flexibility of these Guidelines, this would also significantly vitiate the

predictability of their application and the consistency of enforcement under the Guidelines and would greatly reduce their value as a planning and risk assessment tool for the business community.

While maintaining primary reliance on the concentration and market share analysis discussed in Section 4, the Attorneys General will, under the limited circumstances specified herein, assess three additional factors. These are "ease of entry," collusive behavior and efficiencies.

5.1 EASE OF ENTRY

If meaningful entry into the market can be easily and speedily accomplished, any attempted exercise of market power is likely to fail. For entry to be meaningful it must contribute enough additional product to discipline a price increase or supply restriction. Entry must also be economical, so that there is sufficient incentive to make it likely to occur.[33] Financial, informational, technological and regulatory barriers to entry and those posed by excess capacity will also be assessed. Finally, entry must be likely to occur within one year. While entry requiring longer than this period of time can eventually discipline the exercise of market power, during a year consumers will suffer significant harm of the precise nature which the law was primarily enacted to prevent.

33. Even a significant increase in prices following a merger might not elicit entry since the potential entrants may conclude that their entry into the market could cause prices to drop substantially.

If under the foregoing standards the Attorneys General find that easy and meaningful entry can be accomplished within one year, action to block a merger is unlikely.

5.2 COLLUSION AND OLIGOPOLISTIC BEHAVIOR

If the market has a history of collusion or if there is evidence of current collusion or oligopolistic behavior,[34] the Attorneys General are more likely than otherwise to challenge a merger below one of the numerical thresholds set forth in Section 4[35] and very likely to challenge a merger exceeding any of the numerical thresholds set forth in Section 4.

The absence of collusion or oligopolistic behavior will not diminish the probability of a challenge otherwise likely under the standards set forth in Section 4.

34. An oligopolistic market will usually be moderately to highly concentrated or very highly concentrated and prone to one or more of the following practices: 1) price leadership; 2) pre-announced price changes; 3) price rigidity in response to excess capacity or diminished demand; 4) public pronouncements and discussions of "the right price" for the industry and, 5) systematic price discrimination.

35. An oligopolistic market is unlikely to fall below the numerical concentration threshold of HHI 1000. However, a merger affecting such a market may not increase the HHI enough to make a challenge to the merger likely under the standards set forth in Section 4.

5.3 EFFICIENCIES

To the limited extent that efficiency was a concern of the Congress in enacting section 7, that concern focused on productive efficiency and was expressed in the legislative finding that less industrial concentration would further that goal.[36] The Attorneys General find that there is no substantial empirical support for the assertion that mergers involving firms of sufficient size to raise concerns under the standards set forth in Section 4, usually or on average result in substantial efficiencies. Furthermore, the concentration thresholds adopted in Section 4 are more than high enough to enable firms to obtain the most significant efficiencies likely to result from growth through merger.

Even in those rare situations where significant efficiencies can be demonstrated, rather than merely predicted, this showing cannot constitute a defense to an otherwise unlawful merger.[37] Accordingly, efficiencies will only be considered when the post-merger HHI is 1800 points or below. When the post-merger HHI is 1800 or below the Attorneys General will evaluate any hard evidence offered by the parties that a merger will produce significant efficiencies, such as clearly proven savings on transportation costs or scale economies. In general, proven cost

36. For example, see 95 Cong. Rec. 11,487 (1949) statement of Rep. Celler (co-author of legislation) "Bigness does not mean efficiency, a better product, or lower prices"; 95 Cong. Rec. 11,495-98 (1949) (statement of Rep. Boggs); Corporate Mergers and Acquisitions: Hearings on H.R. 2734 before a Subcomm. of the Senate Comm. on the Judiciary, 81st Cong. 1st & 2nd Sess. 206, 308 (1950) (Statement of James I. Donelly).

37. See Note 13.

savings of 5%, for both firms using a weighted average, will make a challenge to a merger "unlikely" notwithstanding the standards set forth in Sections 4.2 and 4.4.[38] There may, however, be instances where proven cost savings of a lower magnitude may significantly reduce prices to consumers or where the Attorneys General will require evidence of cost reductions in excess of 5%.[39] The Attorneys General will evaluate such claims on a case by case basis.[40]

6. FAILING FIRM DEFENSE

The failing firm doctrine, which has been recognized by the United States Supreme Court will be a defense to an otherwise unlawful merger.[41] Because it may therefore allow anticompetitive mergers, the defense will be strictly construed.

38. In a merger involving the leading firm and innovative firm proviso set forth in Section 4.4, proven cost savings will only be considered if the post-merger HHI is 1000 or below.

39. Example: In an industry with a 1% profit margin, proven cost savings of 3% would be significant.

40. If a merger which produces cost savings of the magnitude specified does not simultaneously facilitate the exercise of market power, these savings should reduce consumer prices, an effect complementary to the purposes of section 7. However, if the merger simultaneously produces these efficiencies and creates or enhances market power, there is no likelihood that consumer prices will be reduced. In such circumstances consumer prices will probably rise as a result of the exercise of market power.

41. U.S. v. General Dynamics Corp., 415 U.S. 486, 507 (1974); U.S. v. Greater Buffalo Press, Inc., 402 U.S. 549, 555 (1971).

The Attorneys General are unlikely to challenge an anticompetitive merger when one of the merging firms is a failing company and satisfies its burden of showing the following three elements: 1) that the resources of the allegedly failing firm are so depleted and the prospect of rehabilitation is so remote that the firm faces the grave probability of a business failure; 2) that it had made reasonable good faith efforts and had failed to find another reasonable prospective purchaser; and 3) that there is no less anticompetitive alternative available.[42]

42. The Attorneys General may exercise their prosecutorial discretion by declining to challenge a merger which will sustain a failing division of an otherwise viable firm. Since the failing division claim is highly susceptible to manipulation and abuse, the Attorneys General will view such claims with the utmost skepticism and in such cases require the three elements of the "failing firm" defense to be proven by clear and convincing evidence.

APPENDIX A

ANTITRUST LAWS OF THE STATES

1. ALABAMA

Section 103 of Art. IV of Alabama Const.
Ala. Code § 8-10-1, 8-10-2, 8-10-3
Ala. Code § 13A-11-122 Combination & Conspiracy

Crim. § 8-10-1, 8-10-2, 8-10-3, 13A-11-122.

2. ALASKA

Alaska Stat. § 45.50.562 et seq.
" " § 45.50.564
" " § 45.50.566
" " § 45.50.568
" " § 45.50.570
" " § 45.50.571
" " § 45.50.471 et seq. Little FTC Act

Crim. § 45.50.578 only.

3. ARIZONA

Uniform State Antitrust Act
USAA Ariz. Rev. Stat. § 44-1401 to 44-1413
Statutory Provisions Ariz. Rev. Stat.
§ 34-251 et seq.
Ariz. Rev. Stat. § 34-252

Crim. Ariz. Rev. Stat. § 34-252

4. ARKANSAS

Ark. Stat. Ann. § 70-105 - 70-111
" " " § 70-101
" " " § 70-120 - 70-122
" " " § 70-301 et seq.

Crim. No penalties under § 70-101 to 111

5. CALIFORNIA

State Business and Professions Code
§ 16700 - 16760 (Cartwright Act)
§ 17000 - 17101 (Unfair Practices Act)
§ 17200 - 17208 (Unfair Competition Statute)

Crim. Business and Professions Code § 16755

6. COLORADO

Colo. Rev. Stat. title VI, art. IV, § 6-4-101 through 6-4-109 - Restraint of Trade & Commerce
title VI, art. II
§ 6-2-101 - 6-2-117 - Unfair Practice Act

Crim. Colo. Rev. Stat. § 6-4-102
" " " § 6-4-104
" " " § 6-4-107(1)(2)

7. CONNECTICUT

Conn. Gen. Stat. § 35-24 et seq.
§ 35-28 - Connecticut Antitrust Act, conspiracies etc.
§ 35-29 - Exclusive dealing
§ 35-45 - Price Discrim.

Little F.T.C. Act - Conn. Gen. Stat. § 42-110b (a)

Crim. - Comm. Gen. Stat. § 53(a)-161a
Criminal Sanctions for bid rigging on government projects enforced by states' attorneys.

8. DELAWARE

Del. Code Ann. title 6, § 2100 et. seq. - Antitrust Act
§ 2103 - Restraint of Trade
§ 2102(d) Misc. Antitrust provision

Crim. - Del. Code Ann. § 2504

9. FLORIDA

Fla. Stat. § 542.15 et seq.
§ 501.201 et seq. - Little FTC Act

Crim. - § 542.21(2)
§ 542.27(1)

10. GEORGIA

Georgia Constitution Art. III, VIII

There is no modern Antitrust Statute
Ga. Code Ann § 20-504
Provides contracts in general restraint of trade are deemed to be contrary

Crim. - Ga. Code Ann. 26-2308

11. HAWAII

Haw. Rev. Stat § 480-1 et seq.

Crim. - § 480-16
§ 480-4(a) - restraint of trade
" 480-4(b) - price fixing
" 480-6 - refusal to deal
" 480-9 - monopolization
" 480-16(a) - $100,000 or 3 years; $1,000,000

12. IDAHO

§ 48-101 et. seq. - Antitrust Act
§ 48-301 et. seq. - Fair Trading
§ 48-201 et. seq. - Anti-Price Discrimination Act
§ 48-401 et. seq. - Unfair Sales Act

Crim. - § 48-101, 48-102, 48-104, 48-110, 48-111

13. ILLINOIS

Ill. Rev. Stat. ch. 38, § 60-1, et seq.

Crim. - ch. 38, § 60-3[1] & 3[4], 60-6

14. INDIANA

Ind. Code Ann. § 24-1-2-3 - Antitrust
" " " § 24-2-1 - Restraint of Trade

Crim. - § 24-2-1 & 2, 24-1-2-3

15. IOWA

Iowa Code § 553.1 et. seq - Antitrust
§ 553.4 - Iowa Competition Law

Crim. - § 553.14

16. KANSAS

Kan. Stat. Ann. § 50-101 through 50-801

Crim. - § 50-106
§ 50-114

17. KENTUCKY

Ky. Rev. Stat. § 367.175(1) prohibits restraint of trade
" " " § 355.020 et. seq
Unfair Practices Act

No Criminal Penalties

18. LOUISIANA

La. Rev. Stat. title 51, part IV -
title 51, § 331-337
title 51, § 421-42[illegible] -
title 51, § 1401-1418-
Practices Law

19. MAINE

Me. Rev. Stat. title 10, § et seq.

Crim. - Title 10 § 1101 & 1102

20. MARYLAND

Md. Code Ann., § 11-20 1 through 11-213 - Antit

Crim. Comm. Law, § 11-212
§ 11-207
§ 11-207
§ 11-207
§ 11-207
§ 11-207

21. MASSACHUSETTS

Mass. Gen. Laws, ch. 93, § 1 et. seq. - Antitrust Act

Crim. - ch., 93, § 10

22. MICHIGAN

Mich. Comp. Law § 750.151
" 750.557 - Limit control of sale of articles of machinery, tools, etc.
" 750.558 Prohibits trusts

Crim. - § 750.558
" 750.151
" 750.557
" 750.559

23. MINNESOTA

Minn. Stat. § 325 D.49 et seq.

Crim. - § 325D.69, 325 D. 53

24. MISSISSIPPI

Miss. Code § 75-21-1 et seq.

Crim. - § 75-21-1 & 75-21-3

25. MISSOURI

Mo. Rev. Stat. § 416.011

Crim. - § 416.051(1)

26. MONTANA

Mont. Rev. Codes Ann. title 30, ch. 14, § 30-14-101 et seq.

Crim. - § 30-14-224, 30-14-224(2)

27. NEBRASKA

Neb. Rev. Stat. § 59-801

Crim. - § 59-801, 59-802, 59-805, 59-815

28. NEVADA

Sections 598A.010 et seq. of title 52
of the Nevada Revised Statutes
(Nev. Rev. Stat. § 598A.020)

Crim. - § 598A.250, § 598A.240

29. NEW HAMPSHIRE

N.H. Rev. Stat. Ann. § 356:1

Crim. - § 356:4

30. NEW JERSEY

N.J. Stat. Ann. title 56, ch. 9, § 56:9-1

Crim. - § 56:9-11.

31. NEW MEXICO

N. Mex. Stat. Ann. § 57-1-1 et seq. Antitrust Act.
§ 57-14-1 et seq. - Price Discrimination

Crim. - § 57-1-6, 57-1-6A

32. NEW YORK

N.Y. Gen'l Bus. Law § 340 et seq. Donnelly Act

Crim. - § 341 & 347

33. NORTH CAROLINA

Section 34 of Article I of the North Carolina
Constitution - Prohibition against Monopolies, no
comparable statutory prohibition

Crim. - N.C. Gen. Stat. § 75-1, 75-7

34. NORTH DAKOTA

N.D. Cent. Code § 51-08-01 et seq.

Crim. - § 51-08-03, § 51-08-06

35. OHIO

Ohio Rev. Code § 1331.01 et seq. - Valentine Act

Crim. - § 1331.99, 1331.05

36. OKLAHOMA

Antitrust Law - Oklahoma Constitution, Article 2,
Section 32 bans Monopolies
Art. 9, Section 45 - prohibits locality
Price Discrimination

O. S. 1981 title 79, § 3 - Mergers

Okla. Stat. Ann. title 79, ch. 1, § 1 to 7 and
21 to 37 - Restraint of Trade title 15 ch. 4, § 598.1 to
598.11. - Unfair Sales Act

Crim. - title 79 § 27

37. OREGON

Ore. Rev. Stat. § 646.705)

Crim. - § 646.815(1) Vests exclusive jurisdiction for
Crim. Prosecution in the Att'y General No
express provision in the Antitrust Statute
for Crim. Penalties

38. PENNSYLVANIA

No Antitrust Act of General Application

Anti-bid Rigging Act
Pa. Stat. Ann. title 73, § 211 et seq. - Unfair Sales Act

Common Law Remedies

Crim - conspiracy - no statutes, case law title 73, § 214 -
Unfair Sales Act

39. RHODE ISLAND

R.I. Gen. Laws § 6-36-1 et seq.

Crim. - § 6-36-16 of the Rhode Island Antitrust Act
" 6-36-16(a) & (b)

40. SOUTH CAROLINA

S. C. Code, title 39, 39-3-10 & 39-3-130 - Prohibits price fixing
§ 39-3-120 - Monopolies unlawful
§ 39-3-140 - Prohibits group boycotts
§ 39-3-150 - Prohibits sales below cost
§ 39-75-320, 330, 340 Prohibit unfair pricing practices by wholesalers
39-5-10 et seq. - Unfair Trade Practices Act

Misc. Antitrust Provisions
Insurance - § 38-55-30
Motion Pictures § 39-5-510 et seq.

41. SOUTH DAKOTA

Antitrust Provisions
§ 37-1-3 through 33 - Antitrust provisions

Misc. Antitrust Provisions
Insurance - § 58-3802 of ch. 58-33
Petroleum - § 37-2-1 of ch. 37-2, title 37
Cigarettes- § 37-10-1 et seq. of ch. 37-10, title 37
Railroads - § 49-16A-12 of ch. 49-16A, title 49
Trains - § 49-43-33 of ch. 49-33, title 49

Crim. - § 37-1-20

42. TENNESSEE

Tenn. Code Ann. § 47-25-101 et seq.
§ 47-25-201 et seq. Unfair Sales Act

Crim. - § 47-25-103

43. TEXAS

Tx. Business and Commerce Code, title 2, § 15.01)

Crim. - § 15.22

44. UTAH

Utah Code, title 76, ch. 10, § 76-10-911 through 926
Antitrust § 76-10-903 Locality Price Discrim.

Misc. Utah Antitrust provisions
Dairy - Crim. § 76-10-906, Civil § 50-2-2

Electronic Funds Transfer Systems
§ 7-16-15

Automobile Financing
Civil § 41-1-1 41 Crim. § 41-4-9

Motor Fuels
§ 13-16-4

Motion Picture Bidding
§ 13-13-1 et seq.

Crim. - § 76-10-920(1), § 13-13-6

45. VERMONT

No Antitrust Statute of General Application

Vt. Stat. Ann. title 9, § 2451 et seq. - Little FTC Act

Misc. title 8, § 4721 et seq. - Insurance
§ 908 of Title 28 Price Fixing in Sales to States
§ 2751 et seq. of Title 6 Dairy Product

46. VIRGINIA

Code of Va. title 59, ch. 1.1, § 59.1 - 9.1 et seq.

Crim.- No Crim. Penalties

47. WASHINGTON - Wash. Const. Article 12 Section 22 prohibits monopolies and trusts. RCW 19. 86, Unfair Business Practices - Consumer Protection Act, Prohibits Restraints of trade, monopolization.

Misc. Antitrust Provisions
Dairy - RCW 15.32.730
Insurance - RCW 48.30
Cigarettes - RCW 19.91
Agricultural Products - RCW 24.34
Motion Picture Bidding - RCW 19.58

Crim. - No crim. violations for Unfair Business Practices - Consumer Protection Act violations possible case law support for criminal conspiracy

48. WEST VIRGINIA

W. Va. Code § 47-18-1

Crim. - § 47-11A-11 of the West Virginia Unfair Practice Act

Misc. Antitrust Provisions
Petroleum Franchises
§ 47-11c-1 et seq.

Motion Picture Distribution
§ 47-11D-1 et seq.
Bid-Rigging - § 17-4-22
Insurance § 33-11-1 et sec.
Food Products - § 61-10-1°

49. WISCONSIN

Wisc. stat. Ann. § 133.01 title XIVA, ch. 133,
through 133.18

Misc. Antitrust Provisions
Dairy - § 100.201
Insurance - § 628.34
Drugs - § 100.31
Property of Insurance - § 134.10

Crim. - § 123.03(1) & (2)

50. WYOMING

Wycming Constitution, Article X, Section 8 -
Restraint of Trade
Article 1, Section 30 - Monopolies
Wyo. Stat. § 40-4-101 to 105 - Price Discrimination
§ 40-4-106 to 116 - Locality Price Discrimination

Misc. Antitrust Provisions
Insurance - § 26-13-108
Petroleum - § 40-4-117

Crim. - 40-4-115

51. DISTRICT OF COLUMBIA

D.C. Code title 28, ch. 45, § 28-4501 to 28-4518 -
Antitrust Act

Misc. - Prescription Drug Price Info - title 33 ch. 7,
§ 33.742

Crim. - § 28-4506

52. TEPRITORIES OF THE U.S.

Fed. Antitrust Laws Govern., but no
prohibition against Monopolization

53. PUERTO RICO

P.R. Laws Ann. title 10, ch. 13 § 257 - 276

Crim. - title § 266

54. VIRGIN ISLANDS

V.I. Code title 11, ch. 29 § 1501 - Anti-monopoly law

Crim. - title 11 § 1506

APPENDIX B

STATE MERGER STATUTES

ALASKA:	Ak. Stat. § 45.52.040
HAWAII:	Haw. Rev. Stat. § 480-7
LOUISIANA:	La. Rev. Stat. Ann. § 51:125
MAINE:	Me. Rev. Stat. Ann., title 10, § 1102-A (Supp 1984)
MISSISSIPPI:	Miss. Code Ann. § 75-21-13
NEBRASKA:	Neb. Reissue Rev. Stat. § 59-1606
NEW JERSEY:	N.J. Stat. Ann. § 56:9-4 (West Supp. 1984)
OHIO:	Ohio Rev. Code Ann. § 1331.021 (Page Supp. 1983) (concerning oil company mergers)
OKLAHOMA:	Okla. Stat. Ann., title 79, ch. 3, § 84
OREGON:	O.R.S. § 722.072 (domestic savings associations) O.R.S. § 773.110 (air carriers)
PUERTO RICO:	P.R. Laws Ann., title 10, § 261
TEXAS:	Tex. Bus. & Comm. Code Ann. § 15.05(d)
WASHINGTON:	Wash. Rev. Code Ann. § 19.86.060

Senator METZENBAUM. We are very happy to work with you.

Do I understand correctly that you are appearing here officially on behalf of the National Association of Attorneys General?

Mr. ABRAMS. That is correct.

Senator METZENBAUM. We are very happy to welcome my own Attorney General, my good friend, Tony Celebrezze.

Mr. CELEBREZZE. Thank you, Mr. Chairman.

Senator METZENBAUM. We are happy to have you with us, Tony, and please proceed. Are you also speaking on behalf of the National Association of Attorneys General?

Mr. CELEBREZZE. Yes, Mr. Chairman, I am speaking also on behalf of the National Association of Attorneys General. I submitted a testimony statement and I would ask that it be placed in the record.

Senator METZENBAUM. Without objection, it will be included in the record in its entirety.

Mr. CELEBREZZE. Thank you, Mr. Chairman.

Our topic today is mergers and specifically those which eliminate competition between direct competitors, thus allowing the survivor to have an overly dominant role in the marketplace.

I think the need for a clear and consistent and effective policy continues to be demonstrated almost on a daily basis. All of us recognize that there are some instances when mergers are beneficial as they can achieve cost benefits and efficiencies. Our experience as an industrial Nation, however, has shown that limited forms of governmental oversight are necessary for the economy to run smoothly, for all participants in the marketplace to have an opportunity to compete fairly.

Our antitrust and merger laws embody a long-standing belief that excessive concentration results in higher prices and misallocation of scarce resources. The whole purpose behind our statutes that were passed over the years by the Legislative Branch of the government is that antitrust enforcers should not wait until firms achieve monopoly power and raise prices before acting.

The Executive Branch's obligation is to establish policies that are consistent with this mandate from the Legislative Branch. Unfortunately, this administration has followed an uncertain, unrealistic, sort of an "anything goes" policy, and it has resulted in a tidal wave of merger activity, some with very harmful effects.

Under these conditions, we have seen proposed and actual horizontal mergers of unprecedented size. Only under current policy have we seen dominant firms the size of Coca-Cola and Pepsi even attempt to acquire their next largest competitors.

To make matters worse, Federal antitrust agencies have overstepped their role by trying to fix mergers that will not work, by specifying certain divestiture policies in an attempt to lessen the anti-competitive nature of transactions. An experience in our own State of Ohio shows the damaging results of this policy.

When LTV Corporation, the Nation's third largest steel producer, announced its merger with Republic Steel, the fourth largest producer, located in Cleveland, the Antitrust Division announced its intention to challenge the merger. This position was publicly second-guessed by Secretary Baldrige of the Commerce Department and by President Reagan himself.

Under this pressure, the division soon reversed its position and hurriedly devised a quick-fix solution which required LTV to divest itself of two previously profitable steel plants. It soon became clear that the buyer of the spun-off Enduro plant in Massillon, Ohio, was under-capitalized and unable to run that plant. Within a year, the plant closed and 700 jobs in the City of Massillon were lost, all a direct result of the administration's policy and unrealistic and inappropriate action by the Antitrust Division.

The severe weight of such a closing falls heaviest on the dislocated workers and their families and is also borne by State and local governments and the economies of the State and local areas in the form of greater unemployment, higher welfare costs, and an eroded tax base.

Ironically, even this ad hoc policy in the antitrust arena backfired. The closing of the previously profitable Enduro plant reduced competition in the already concentrated market for stainless sheet and strip steel. Obviously, there are major problems with this type of a merger policy.

Previous administrations, both Republican and Democratic, took the view that proposed mergers should either be approved or challenged, and that any corrective action should be made by the companies involved before approval is sought. We need to return to that kind of thinking in this arena.

In the absence of effective federal action, States and private companies have had to fill the void. A couple of years ago I and several of my colleagues, along with the Chairman of this subcommittee, were active in challenging a proposed merger of Norfolk-Southern and CONRAIL, two of the three largest railroad systems in the northeastern States.

The concerns that were expressed then in the antitrust arena I am convinced played a definite role in the decision to drop that proposed sale.

The current climate here has forced the States to take an aggressive posture to object and challenge anti-competitive mergers. Our consistent opposition to the lack of enforcement policies of the Federal authorities has highlighted the need for the States to set forth in writing their own enforcement policies, thus providing the business and the legal communities with a predictable guidance plan as to what type of action can be expected from the States.

The National Association of Attorneys General, as Mr. Abrams has stated, has finalized and adopted our guidelines. We believe that the guidelines more accurately reflect the concerns of this Congress and the public in general than do the guidelines offered to you by the administration and its so called Merger Modernization Act proposed last month.

Mr. Chairman, in conclusion, I would suggest to you that a sensible merger and antitrust policy has to take into account the actual costs and benefit of the merger as well as the ability of the enforcement agencies to weigh these costs and benefits.

Our policy has to provide the business community with consistent guidance and a certainty of outcome, rather than a constantly sliding change of rules. Most of all, any policy adopted has to be established with the good of the consumer and the marketplace uppermost in the minds of those that establish that policy.

Thank you, Mr. Chairman.
[The prepared statement of Mr. Celebrezze follows:]

TESTIMONY STATEMENT

OF

ANTHONY J. CELEBREZZE, JR.
ATTORNEY GENERAL OF OHIO

I want to thank Senator Metzenbaum and the members of the Subcommittee for inviting me to speak this morning. I have been invited to speak on behalf of the National Association of Attorneys General. I wish to discuss mergers, specifically horizontal mergers, and the role of the antitrust laws. A merger occurs when one firm acquires the stock or assets of another. Often, mergers can be beneficial, by enabling the merging firms to achieve cost savings and economic efficiencies. Generally speaking, in our free enterprise system businesses are free to organize and arrange the ownership of stock and assets as they please; the object is that the "invisible hand" of the marketplace will reward the successful and penalize the inefficient, and that consumers will be the ultimate beneficiaries.[1]

Our experience as an industrial nation, however, shows us that limited forms of governmental oversight are necessary if the economy is to run smoothly, and if all participants in the marketplace are to have a fair opportunity to compete. One form of oversight which is currently under close analysis is the need for more effective regulation of hostile takeovers, in light of the debilitating effects such takeovers, successful or not, can have on firms and the overall economy.[2] Another very important form of oversight is that of antitrust policy.[3] The antitrust laws, and Section 7 of the Clayton Act in particular, are intended to promote and preserve a competitive economy.[4] Merger law is premised on the long-standing belief that the evils of excessive concentration, such as higher prices and misallocation of scarce resources, should be checked in their incipiency. Antitrust enforcers should not wait until firms achieve monopoly power and raise prices and restrict output; the Clayton Act by its terms

forbids those mergers that may have the tendency to substantially lessen competition.[5] The executive branch's enforcement obligation is to establish policies consistent with this legislative mandate.

This Subcomittee should be commended for taking the time to analyze government merger policy. Just last month, Ohio Governor Celeste introduced and the National Governors Association passed a resolution calling for congressional review of the enforcement and adequacy of antitrust merger laws. Because of the Supreme Court's recent Monfort decision,[6] where it ruled that a firm did not have standing to challenge a merger of two of its competitors, the government's role in antitrust enforcement takes on increased importance. Under certain circumstances, if the government declines to challenge a merger, the legality of a merger may go entirely untested. This fact underscores the need for a consistent, fair and tough federal merger policy. Large scale horizontal mergers that have the capacity to lessen competition must be scrutinized under realistic and workable standards which insure adequate protection of the public purposes served by the Clayton Act.

Unfortunately, our experience over the past six years is the effect of an unrealistic and uncertain policy. Under the current Administration, the adherents to the so-called "Chicago School" of economic learning have had exclusive control over federal merger policy. Their view is that no enforcement is the best enforcement, and that almost all enforcement initiatives brought under previous administrations, Democratic and Republican alike, were ill-conceived and detrimental, because they did not always conform to Chicago School principles. Administration officials tend to regard economic markets as inherently self-correcting and choose to believe that the exercise of monopoly power by a firm is usually implausible because competitors will increase production and gain sales should the monopolist raise prices or restrict output.[7]

But what works well as an economic theory cannot always be

easily applied to the real world. We have seen, through the work of Professor Louis Lowenstein and others, the faulty assumptions and adverse results of the Administration's economic thinking in the area of hostile takeovers, where the results are often disastrous.[8] So too, in the antitrust field, the Administration has adopted a policy which is both unproven and unworkable, and which runs counter to the purposes of the Clayton Act, accepted legal precedent and substantial economic learning. Further, the Administration's policies have been flawed by inconsistency in application, with deviations being almost always in favor of even greater leniency.

This approach creates an inherently unstable situation, one where enforcement policies and practices are inconsistent with judicial decisions. Federal enforcement policy has not followed the guidelines set out in court decision, thus generating even more litigation. We have seen private parties succeed on Section 7 claims based on the Antitrust Division's stated policy, even after federal authorities have declined to challenge the merger in question.

For example, in 1985 the FTC approved a merger between Whirlpool and KitchenAid, the third and fourth largest firms in a highly concentrated major home appliance market.[9] The Commission found that this merger raised the Hirschman-Herfindahl Index's measure of concentration by 200 points to nearly 2300. The DOJ Merger Guidelines state that "If the increase in the HHI exceeds 100 and the post-merger HHI substantially exceeds 1800, only in extraordinary cases will such mitigating factors establish that the merger is not likely to substantially lessen competition."[10] There is some authority that a merger may fall into the "extraordinary" category where entry barriers are low. But in the Whirlpool case, there was a consensus that entry barriers were high. As Commissioner Bailey said in her dissent, "the only 'extraordinary' thing about [the merger] may be the Commission's decision not to challenge it."[11]

In a private action filed after the Commission's decision, a federal district court granted an injunction against the

merger.[12] The Department of Justice now cites this case as an example of judicial recognition of its merger guidelines.[13] But the court, using the guidelines, found a probable violation of Section 7 in a merger which the government declined to challenge. The district court then vacated the injunction after the merging parties agreed to a curative divestiture, and the Court of Appeals for the Sixth circuit affirmed the district court's decision.[14]

Enforcement guidelines are promulgated as a guide to business regarding government decision-making criteria. If they have any practical utility it is in their predictive value. As the Whirlpool case illustrates, this Administration's failure to consistently apply its own stated enforcement policy robs the guidelines of any predictive value they may have.

In this state of uncertainty and leniency in enforcement policy, the perception of the business community is that "anything goes" - thus we have seen under the present administration proposed and actual horizontal mergers of unprecedented size. Only under current policy have we seen dominant firms the size of Coca-Cola and Pepsi even attempt to acquire their next largest competitors.[15]

As federal enforcement agencies continue their assault on the intent and spirit of the merger laws, firms will increasingly test the limits of the laws. One important development in current antitrust enforcement is that mergers that would not have been permitted by previous administrations are being structured by the enforcement agencies in an effort to rationalize why approval can be granted. Both the FTC and the Antitrust Division are participating in the design of structural "fixes" in expedited merger investigations. The antitrust agencies have made it clear that almost any merger can be fixed by the government, by way of specifying discrete and often unrealistic divestiture requirements.

Government intervention in the reorganization of businesses is basically incongruous with the laissez-faire platitudes of the Administration. Antitrust law is based on a reliance upon

market competition and a skepticism toward direct government intervention.[16] Antitrust is intended to facilitate the conduct of enterprise by prohibiting restraints and control of markets. The current federal antitrust policy, however, places increasing reliance upon the subjective judgments of agency officials, as opposed to the past reliance upon business judgments made under objective and consistent legal standards.

One major problem with this new approach to merger enforcement is that business reorganizations of significant scope are initiated, carried out, or approved by enforcement officials with an incomplete or ideologically biased picture of the market.[17] The costs can be substantial.

When LTV Corporation, the nation's third largest steel producer, announced plans to acquire Republic Steel, the fourth largest producer, the Antitrust Division announced its intention to challenge the merger.[18] This position was publicly second-guessed by Commerce Secretary Baldrige and President Reagan. Within weeks the Division reversed its position.[19] In so doing it engaged in a restructuring of the merging firms that profoundly affected the industry, thousands of workers and several communities.

Under strong political pressures and within the limited time provided by the Hart-Scott-Rodino deadlines, the Antitrust Division took upon itself the task of evaluating all aspects of the merger, including its claimed efficiencies, the effects of U.S. international trade policy, and the need for spinning off particular plants. Moreover, the Division undertook the task of determining the fitness of the buyer. The Division required LTV to divest itself of two previously profitable steel plants and selected buyers for each plant, in spite of a staff recommendation that other buyers be considered.

It soon became clear that the buyer of the spun-off Enduro Plant in Massillon, Ohio was undercapitalized and unable to successfully operate the plant. Within a year, the plant closed and 700 persons lost their jobs, all as a direct result of a hurried application of an unrealistic antitrust

policy.[20] The severe weight of such a closing falls heaviest upon dislocated workers and their families, and is also borne by the state and local economies in the form of greater unemployment, higher welfare costs and an eroded tax base. Moreover, the closing of the previously profitable Enduro Plant reduced competition in the already concentrated market for stainless sheet and strip steel.

This type of ad hoc interventionism based on highly subjective criteria applied under significant time constraints is overly susceptible to short term expediencies and errors in judgment. Previous administrations took the view that the original proposed merger should either be approved or challenged, and that any fixes should take place before approval is sought.[21] We should return to a policy that relies or clear presumptions based on structural increases in concentration, such that the federal antitrust authorities do not have to engage in the potentially disastrous quick fix policy. Far more is at stake than simply a debate between different schools of economic theory.

The substantial adverse effects that curative divestitures can have on local communities have led me to support the effort by the Chairman of this Subcommittee, Senator Metzenbaum, and Senator Glenn of my state, to amend Section 5 of the Clayton Act (popularly known as the Tunney Act). The proposed legislation, first introduced in the Senate last year, would require any proposed divestiture to fully restore competition and would provide greater scrutiny of the selected buyer of the divested assets. The bill would require that reasonable steps be taken to protect the interests of affected employees to preclude them from becoming innocent victims of errors in judgment by enforcement agencies. State attorneys general would have a right to intervene in consent decree proceedings where proposed divestitures would affect the jobs of 100 or more full-time employees in their states. I am pleased that my colleagues in the National Association of Attorneys General have voted to join me in support of this proposed bill as part

of our nine section antitrust legislation proposal. We must make every reasonable effort to insure that the adverse effects of antitrust divestitures are minimized.

The track record of lenient enforcement policy at the federal level compels me to counsel careful and intense scrutiny by this Subcommittee of any proposals by the Administration or others to tamper with the language of the Clayton Act in an attempt to permanently codify a laissez faire enforcement policy. The Administration's Merger Modernization Act, unveiled last month, is just such a proposal.[22] Under this proposed legislation, the Administration seeks to essentially repeal the Clayton Act and replace it with a law which would make it almost impossible to prove that a merger is unlawful. The bill explicitly raises the burden of proof required to establish the violation, and totally eliminates any presumptions that might otherwise be available based on the proof of an actual increase in concentration.[23] The proposal would do away with over fifty years of complex and changing case law construing the Clayton Act and inject a high degree of uncertainty into the business arena. Further, much of what the Administration wishes to codify is wholly unnecessary because the courts and enforcement agencies already consider such non-structural factors as ease of entry, market conduct, and efficiencies.[24]

The strength of the Clayton Act as it currently stands is that it has proven sufficiently flexible to keep pace with economic learning and judicial experience in the real world, where actual mergers are considered. We should be wary of any attempts to legislatively lock enforcement agencies and courts into any single form of economic analysis that may be in vogue at one point in time. The Administration will be hard pressed to argue that we need to tamper with our merger laws when some of its own proponents have argued to the contrary. Former Assistant Attorney General J. Paul McGrath, who served the current Administration from 1984 to 1985, has gone on record as saying that current merger law is sufficiently flexible to account for changes in industries and in the nature of

competition.[25] Distancing himself from those members of the Administration who hold antitrust laws to blame for America's trade deficits, Mr. McGrath has remarked that blaming the antitrust laws for our inability to compete in some international markets is akin to blaming the third base coach for the New York Yankees' failure to win the American League pennant.[26]

Based on these considerations, I am sure that I can speak on behalf of my fellow Attorneys General from around the country in urging this Subcommittee to view with skepticism the Administration's attempted merger revisions.

As Professor Scherer has noted, a sensible merger policy must take into account the costs and benefits of mergers and the ability of enforcement agencies to weigh those costs and benefits. An enforcement policy must be both realistic and workable, and provide business with some certainty as to how it will be applied. To be effective, a merger policy must delineate as clearly as possible those situations where a merger is likely to be challenged, as opposed to those situations where no action is likely.[27] Unfortunately, the current Administration's merger policy does not meet this basic requirement.

Most of the effective merger enforcement in the last several years has been conducted not by federal authorities but by the states and private parties. For example, when Mobil Corporation attempted to take over Marathon Oil, it was Marathon who sued for and obtained a preliminary injunction against the attempted takeover.[28] The District Court found that Marathon showed a reasonable probability of proving at trial that the merger would result in a substantial lessening of competition in the states of Illinois, Indiana, Michigan, Ohio, Tennessee and Wisconsin as a result of the proposed merger. Concluding that a dismemberment of Marathon could do damage to competition in the marketplace, the Sixth Circuit Court of Appeals affirmed Judge Manos' decision.[29]

Similarly, when Heileman Brewing Company attempted to take over Pabst, it was two competitors, Schmidt Brewing and Stroh

Brewing, who sued to obtain a preliminary injunction against the acquisition. The District Court in Michigan found, in an opinion affirmed by the Sixth Circuit, that the attempted takeover would likely reduce competition in 12 states in the Upper Midwest.[30]

Last year, when May Department Stores proposed to acquire Associated Dry Goods Corporation. the City of Pittsburgh and the State of Pennsylvania filed suit to block the acquisition because the result would be almost total control of the traditional department store market by the May Company.[31] May Company settled the case by agreeing to sell to a third party its Joseph Horne Company division to alleviate the antitrust concerns. Because of the aggressive action taken by the government officials of Pennsylvania, competition has been preserved in the retail market in various cities in both Pennsylvania and northeastern Ohio.

Another example of merger enforcement activity undertaken by the states was the activity that I and other state Attorneys General undertook with respect to the proposed sale of Conrail to Norfolk-Southern. I vigorously lobbied Congress and pointed out the substantial anti-competitive consequences of a merger of two of the three largest rail systems in the northeastern and midwestern United States. Our antitrust concerns played a substantial role in the decision by congressional leaders not to go ahead with the sale to Norfolk Southern.[32]

The current climate has forced the states to take an aggressive posture with respect to anti-competitive mergers. Our consistent opposition to the lax enforcement policies of the federal authorities has highlighted the need for the states to set forth in writing their own enforcement policies, thus providing the business and legal communities with guidance as to what type of action can be expected from the states. The National Association of Attorneys General has just finalized a set of horizontal merger guidelines intended to provide a coherent, rational set of criteria based on sound legal precedent and accepted economic learning. Attorney General Abrams from New York will decribe these guidelines in more

detail. I wish to simply note that the NAAG guidelines differ from those of the Department of Justice in that they try to set forth the state of the law as it currently exists rather than representing a vision of what one school of economists think the law should be. The NAAG Guidelines are workable in that they preserve key structural presumptions while allowing consideration of other factors. We believe that the NAAG guidelines more accurately reflect the concerns of this Congress and of the public in general than do the Department of Justice Guidelines. We adhere to the accepted Congressional concern that excessively high levels of market concentration are harmful to the economy and to the consumer.

1: Adam Smith, An Inquiry Into the Nature and Causes of the Wealth of Nations (New York: Modern Library, 1937).

2: F.M. Scherer Takeovers: Present and Future Dangers, The Brookings Review 15-20 (WTR/SPC 1986).

3: I deliberately avoid use of the term "regulation" to describe antitrust law. Most regulation intends to displace competition, on the premise that free market principles do not operate in a given industry. In contrast, antitrust laws are designed to preserve the competitive process - intended to function more like a referee than a dictator.

4: See P. Areeda and D. Turner, I Antitrust Law ¶103-113 (1978 et. seq.).

5: 15 U.S.C. §18.
In 1950, Section 7 was amended by the Celler-Kefauver Antimerger Act (64 Stat. 1125) to include asset as well as stock acquisitions. The section was also expanded to reach non-horizontal mergers and acquisitions that would tend to substantially lessen competition or create a monopoly "in any line of commerce in any section of the country."

Section 7 was amended by the Antitrust Procedural Improvements Act of 1980 (Pub. L. 96-349, §6(a), 94 Stat. 1157) to include acquisitions by "persons engaged in any ... activity affecting commerce."

6: Cargill, Inc. v. Monfort of Colorado, Inc., 105 S.Ct. 484 (1986).

7: Address by Daniel Oliver, Chairman, Federal Trade Commission, reprinted at 55(2) Antitrust L.J. 349, 353 (1986).

8: Lowenstein, Hostile Takeovers: New Data on an Old Question, paper presented to the ABA Section on Taxation (1986); E. Herman and L. Lowenstein, The Efficiency Effects of Hostile Takeovers: An Empirical Study, paper presented at a Columbia University Law School conference on Takeovers and Contests for Corporate Control (1985); J. Pound, Are Takeover Targets Undervalued? An Empirical Examination,

(Investor Responsiblity Research Center, 1986); D. Ravenscraft and F.M. Scherer, "Life After Takeover" and "The Profitability of Merger", working papers, 1986.

9: In Re Whirlpool Corp., 4/16/85 (FTC).

10: U.S. Department of Justice Merger Guidelines, 49 Fed. Reg. 26,831 (1984).

11: In Re Whirlpool Corp., 4/16/85 (FTC) (Comm'r Bailey, Dissenting).

12: White Consolidated Industries, Inc. v. Whirlpool Corp., 612 F.Supp. 1009 (N.D. Ohio 1985).

13: Charles F. Rule, Assistant Attorney General, U.S. Department of Justice, Letter to Lloyd Constantine, Assistant Attorney General, State of New York Department of Law, January, 1987.

14: White Consolidated Industries, Inc. v. Whirlpool, Corp., 619 F.Supp. 1022 (N.D. Ohio 1985), aff'd, 1986-1 Trade Cas. (CCH) ¶66,930 (6th Cir. 1986).

15: Coke's proposed acquisition to Dr. Peper and Pepsi's contemporaneous proposed acquisition of Seven-Up would have given the two firms a combined 80% share of the soft drink market. "Coke to Acquire Dr. Pepper Co. for $470 Million. Accord Along with Pepsi's Plan to Buy Seven-Up Spurs Antitrust Concerns," Wall St. Journal, Feb. 21, 1986.

Documents filed in a related matter in the U.S. District Court in Columbus, Georgia, substantiated claims that Coke's proposal was simply taken in reaction to Pepsi's proposed merger, since Coke expected the FTC to approve the Pepsi-Seven-Up merger. "Federal Judge Blocks Coke-Dr. Pepper Merger", AP, June 31, 1986.

16: See P. Areeda and D. Turner, I Antitrust Law ¶103-113 (1978 et. seq.); A. Lipsky, Antitrust Without Apology, 31(2) Antitrust Bull. 481 (1986).

17: B. Owen, The Evolution of Clayton Section 7 Enforcement and the Beginnings of U.S. Industrial Policy, 31(2) Antitrust Bull. 409 (1986).

18: LTV-Republic Merger Would Trigger Antitrust Division Attack, 46 Antitrust & Trade Reg. Rep. (BNA) 270 (Feb. 16, 1984).

19: Justice Clears LTV-Republic Merger with Spinoff of 2 Republic Steel Plants, 46 Antitrust and Trade Reg. Rep. (BNA) 577 (Mar. 22, 1984).

20: "LTV-Republic: Did Justice Blow It?" Business Week P. 56, January 6, 1986.

21: B. Owen, The Evolution of Clayton Section 7 Enforcement and the Beginnings of U.S. Industrial Policy, 31(2) Antitrust Bull. 409, 422 (1986).

22: Merger Modernization Act of 1987, reported in 52 Antitrust and Trade Reg. Rep. (BNA) 348-352 (Feb. 19, 1987).

23: Id.

24: N. Yoerg, M. Leddy, R. Davis and T. Hill, Non-Market Share Factors in Horizontal Merger Analysis, 54(1) Antitrust L.J. 1255(1985).

25: J.P. McGrath, Necessary Flexibility is Already Present Under the 1982 and 1984 Merger Guidelines, 55(1) Antitrust L.J. 13 (1986).

26: Id.

27: F.M. Scherer, Industrial Market Structure and Economic Performance (2d ed. 1980), pp. 544-546.

28: Marathon Oil Corp. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981), cert. denied, 455 U.S. 982 (1982).

29: Id.

30: Christian Schmidt Brewing Co. v. G. Heileman Brewing Co., Inc., 753 F.2d 1354 (6th Cir. 1985), cert. dismissed, 105 S.Ct. 1155 (1985).

31: Pennsylvania v. May Department Stores Co., No. 86-1866 (W.D. Pa. 1986).

32: Statement of Hon. John D. Dingell on Conrail, April 29, 1986.

Senator METZENBAUM. Thank you.

Mr. CELEBREZZE. I would be happy to answer any questions.

Senator METZENBAUM. Let me ask you, do you feel now that the Attorneys General have, as I understand it, unanimously adopted this position, that people of this country can look to the Attorneys General for enforcement of the antitrust laws of the country and that they need no longer turn to the Federal Government, or is it the fact that it is a hodge-podge of laws that the Attorneys General have in this area throughout the country and therefore one State could be very effective in enforcing the law and other States have practically no laws to enforce?

Mr. CELEBREZZE. Mr. Chairman, I think the key to any policy is consistency and predictability. I do not think that the action that NAAG has taken in adopting guidelines in any way should turn the concentration away from an effective and predictable and consistent Federal policy of merger guidelines.

States have different statutes. What we have attempted to do as an organization is to put forth as a group what we will look at in any type of merger. That should give some predictability to the business community in that there are fifty Attorneys General in the States and five in the territories that will be roughly following these guidelines.

I think it is important that any time someone comes to a regulatory agency there be some predictability as to what the outcome of the question will be, and that is really what we are trying to do here. We are not trying to take away anything from the need for a consistent and a vigorous Federal policy in this arena.

Mr. ABRAMS. Mr. Chairman, I might add, too, that these guidelines embody the the principles utilized by the State Attorneys General in enforcing the Federal Sherman and Clayton Acts as they contemplate review or analysis of mergers.

Of course, we look forward to the strong leadership, enforcement and utilization of resources available at the Federal level. The States have taken this position to fill the gap and the void that has been created because of a lack of enforcement by the Federal authorities.

Senator METZENBAUM. Let me postulate a kind of situation. Attorney General Celebrezze has indicated that he and, I guess, others as well were prepared or did go into court to challenge the Norfolk-Conrail merger, is that correct? Did you actually go into court?

Mr. CELEBREZZE. No, sir, we did not actually go into court.

Senator METZENBAUM. You threatened to?

Mr. CELEBREZZE. We were prepared to.

Senator METZENBAUM. My question is is it possible that we could come to a position in this country where Ohio, for example, would be challenging an LTV-Republic merger in Ohio that the Attorney General of Texas, where their headquarters are, would find no fault with, and that the Attorney General of New York might be on one side or the other? Could they get themselves into a position, if the Attorneys General move forward and follow the position that they are talking about and provide for effective enforcement, where the American business community would almost be crying to have one standard applicable throughout the entire country, just

as they came to us recently in connection with a uniform appliance efficiency standard?

Six years ago or 4 years ago, whatever it was, they were totally opposed to the law, then the States started passing their own laws in that area and so they turned to Congress and said please, pass it so we have one standard throughout the Nation, rather than having different standards. What about that aspect of this issue?

Mr. ABRAMS. Well, the whole point of the guidelines, Senator, is to bring about uniformity, to bring about coherence, consistency, uniformity, predictability. These issues are of concern to the 50 States and that is why a great deal of time has been placed in the development of these guidelines.

Again, irrespective of where we are located in the country and our political or ideological positions, we have come together in a unanimous way to say that this represents our overall attitude as we approach antitrust issues for purposes of enforcement.

Senator METZENBAUM. Mr. Abrams, how do you explain the fact that you had unanimity in supporting a strong effective antitrust enforcement policy. You have, I know, a diverse kind of political involvement, you have Republican and Democratic Attorneys General. How do you explain this strong unanimity in that area, failure at the White House level and some of my colleagues sort of suggesting or raising a bogeyman that this is a Democratic program or a liberal program, this is antibusiness, all of those canards that are so often used—and I guess being Democratic is not exactly a canard, but I think some would like to make it that?

My question to you is how do you reconcile this strong position taken unanimously by your group and the failure of the administration and some of my colleagues on the other side of the aisle to be very back-sliding on the whole issue of effective antitrust enforcement?

Mr. ABRAMS. I can only speak from the perspective of the State Attorneys General who have as part of their responsibility enforcement of State and Federal antitrust laws. I think they take that responsibility seriously. I think they are part of the historical tradition, when one looks at the century since the antitrust laws have been passed. One finds that there has been a pretty consistent attitude about enforcement, irrespective of the party in power in a given State at a given moment. The State Attorneys General feel strongly that these laws are critically important, they are the Magna Carta for the free enterprise system in this Nation, they have worked well, they are important, and it is our duty and obligation to step up and enforce those laws and take appropriate action when we feel that that action is warranted.

Senator METZENBAUM. Let me ask you, Attorney General Celebrezze, on a little different subject than mergers: A constituent of mine and yours called the other day with reference to a matter that I think does have to do with free competition, and reported to me that a major national manufacturer was threatening to withdraw his right to sell that corporation's products if the distributor, if that individual or that company carried products manufactured by a competitor. In other words, it insisted, "Look, if you want to represent our company, then you can't represent Company Y as well."

What about our State laws on that, are they applicable? Is there any recourse?

Mr. CELEBREZZE. There would be some recourse under the Ohio statutes.

Senator METZENBAUM. There would be some recourse?

Mr. CELEBREZZE. There would be some recourse. Now, obviously we would look at each situation individually and try to ascertain the facts and see whether we felt we had a strong enough case to bring action.

I think what we are trying to get at in our testimony and by the actions of the Attorneys General is to give some predictability to this entire process. If that in fact happens, there is recourse perhaps at the Federal level; perhaps at the State level. I think that what we are trying to say is that we feel that at the Federal level right now there are things going by that should not be going by.

It is frustrating sometimes in an individual State to try to take on an issue that obviously has regional or even national implications without some help from the Federal level. We have seen this kind of a lessening of the process in this area and others as Attorneys General. I think it is important that everyone carry out their responsibility.

We would have some recourse in that situation under Ohio law, but it would be much stronger recourse if the national company is doing this in more than one State, there is some umbrella enforcement at the Federal level.

Senator METZENBAUM. I think it is only fair to say that you are not going to get enforcement at the Federal level on this kind of an issue and I think that it would be difficult to develop the evidence around the country of that kind of action just by reason of whom do you ask.

Mr. Abrams, what about in New York State? Did you understand my question?

Mr. ABRAMS. Yes. Again, as the Attorney General from Ohio indicated, every situation turns on many facts and you do not want to speak prematurely in giving a conclusion, but the kind of general outline that you formulated sounds as if that would warrant a real close look because it could well be in violation of vertical restraint guidelines that NAAG adopted in 1985 and under principles contained in the State and Federal antitrust laws of this Nation.

Senator METZENBAUM. Thank you very much. Thank you very much, both of you, for participating and your entire statements will be included in the record.

Mr. ABRAMS. Thank you.

Mr. CELEBREZZE. Thank you, Mr. Chairman.

Senator METZENBAUM. Our next panel is Mr. Robert Pitofsky, Dean of Georgetown University Law Center; Professor F. M. Scherer, Department of Economics, Swarthmore College, in Pennsylvania; John D. Ong, Chairman of the Board, B. F. Goodrich Company, Akron, speaking on behalf of the Business Roundtable; and Ernest Gellhorn, representing Jones, Day, Reavis and Pogue, of my own city as well as many other cities.

A PANEL CONSISTING OF: ROBERT PITOFSKY, DEAN, GEORGETOWN UNIVERSITY LAW CENTER; JOHN D. ONG, CHAIRMAN, B.F. GOODRICH CO., ON BEHALF OF THE BUSINESS ROUNDTABLE; ERNEST GELLHORN, JONES, DAY, REAVIS & POGUE; AND F.M. SCHERER, DEPARTMENT OF ECONOMICS, SWARTHMORE COLLEGE

Senator METZENBAUM. Mr. Ong, I want to say to you at the inception that you are supposed to have an appointment with me today. I am unable to make it but you are welcome to come in at some other time and I would be happy to see you, sir.

Mr. ONG. I appreciate that, Senator. Thank you.

Senator METZENBAUM. Mr. Pitofsky, I think you are our first witness. We are happy to have you, sir.

Mr. PITOFSKY. Thank you, Senator. I am very pleased to have this opportunity to participate in these important oversight hearings.

I agree with the comment that you made earlier that we are, in the seventh year of the Reagan administration, witnessing the most lenient merger enforcement policy that we have seen in this country in 50 years. This lenient policy is one factor—not the only factor—that has led to an astonishing surge of mergers.

Perhaps one of the most eloquent pieces of evidence of that major mania was the box score on the front page of the New York Times yesterday, where the Times reported the American Motors-Chrysler proposed merger and then listed five other major mergers, apparently announced that day under the heading, "Merger Plans Sweep the Economy," more or less like the runs scored by a visiting team in a box score.

By these remarks, I am not suggesting that we go back to the kind of merger enforcement that prevailed in the 1960s. My own view is that 1960's style enforcement was excessive. We were striking down mergers among tiny companies, horizontal mergers of 5 percent, vertical mergers of 1 or 2 percent, and I think ignoring considerations of efficiency.

We then moved in the 1970s to a more cautious, fact-oriented, discriminating approach, but that was only a prelude to the extremely lenient policy that we see today. I would almost call this lenient policy an institutional crisis, because non-enforcement effectively deals the courts and Congress out of the game. Despite what Mr. Rule said earlier, I see no support in the courts for the kind of movement toward soft merger enforcement that we have witnessed in the last seven years, certainly not in the Supreme Court, and I see no reason to think that Congress has reconsidered what it did in 1950 in tightening the merger laws.

Part of the problem is in the merger guidelines, although I would start by saying I think the 1982 and 1984 guidelines are a very respectable and essentially sound piece of work. They retained the key assumption underlying merger enforcement, which is that consumers would be hurt by undue concentration. They list a large number of relevant factors. They generally make good sense.

My sharpest quarrel with the guidelines concerns their attitude toward evidence. As you know, the question of merger enforcement often turns on the question whether the parties to the merger can

raise price after the merger to harm consumers. There are two ways to look at that issue. In one, you look at the past and see if in fact prices were raised, you look at hard evidence of what happened in the real world; in the other, you speculate about what will happen, by bringing in economists, accountants and other experts to offer their views about what might happen.

The guidelines are essentially indifferent to those two kinds of evidence. They take all sorts of speculation about foreign competition, about new product entry, about product substitutability into account—as an indication that the merger will lead to no undue exercise of market power.

It seems to me that one of the reasons we have seen so few cases in recent years is because the government so often is persuaded by this kind of speculative evidence.

The main point I wanted to make this morning, however, does not relate to the guidelines, which I have already said are a very respectable achievement, but rather with enforcement.

The guidelines say that where concentration is at less than 1,000 on the Herfindahl scale, that is where four firms have less than 50 percent of the market, that is more or less a "safe harbor" and the government will not intervene. I think that is a rather lenient definition of a "safe harbor" but a sensible idea.

The guidelines also say that where concentration is over 1,800, that is to say when four firms account for 70 percent or more, and the merger adds about 100 points, the government will almost always sue.

Then the guidelines say in that vast area between, 1,000 to 1,800, they are likely to sue when the merger has a significant impact. The fact of the matter is in 7 years the Department of Justice has not brought a case against a merger in the 1,000 to 1,800 zone and they have frequently allowed mergers to go through even where they occurred in markets that were more concentrated than 1,800 on the Herfindahl scale. Thus, the department in its enforcement efforts has come close to abandoning its own guidelines.

Thank you.

[The statement follows:]

TESTIMONY

of

ROBERT PITOFSKY

Professor of Law and Dean,
Georgetown University Law Center

Before the

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

Concerning

OVERSIGHT HEARINGS ON MERGERS

March 11, 1987

I appreciate the opportunity to testify in these important legislative hearings overseeing the performance of the Department of Justice in regulating merger activity under the antitrust laws.

The importance of these oversight hearings can be underscored by a brief review of recent antitrust history. Congress amended Section 7 of the Clayton Act in 1950 because it was concerned about a rising tide of industrial concentration in the United States, and the Warren Court, in the first decade of interpretation of Section 7, expanded the reach of the statute. In the period 1960 through 1972, merger enforcement was extremely vigorous in this country.

I believe some of the decisions in that period were unduly restrictive. Horizontal mergers were struck down among relatively small companies, even in markets where cartels were unlikely because of low barriers to entry,[1] and vertical mergers successfully challenged where the portion of the market foreclosed was tiny, and where the merger could not have resulted in any significant harm to competition.[2] There were only a few

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[1] For example, see United States v. Vons Grocery Co., 384 U.S. 270 (1966) (violation in grocery retailing where combined market shares were 7.5%).

[2] Brown Shoe Co. v. United States, 370 U.S. 294 (1962) (foreclosure in the vertical line measure at 1.2 or 1.6%).

decisions striking down conglomerate mergers, but the opinions in those cases were sweeping and put forward some theories that were questionable on the basis of any economic analysis.[3]

The pendulum began to swing toward a more discriminating enforcement stance in the 1970s. This change probably occurred partly because of a concern about the ability of U.S. companies to compete effectively in international trade. But the main reason was that the earlier cases were difficult to defend on any theory except one that sought to prevent American businesses from growing larger through mergers in order to preserve social values associated with a less industrialized way of life. That was not a clear theme in Congressional thinking when it amended Section 7 in 1950 and, if carried to extremes, would be very costly to the nation in terms of the efficiency of its industrial sector.

But those changes toward a more discriminating merger policy were modest and cautious. For example, in enforcement against horizontal mergers, cases usually were not brought unless combined market shares were in the 10-15% range. Also far more attention was given to

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[3] See Federal Trade Commission v. Proctor & Gamble Co., 386 U.S. 568 (1967) (violation found, in part, because the merger led to distributional efficiencies).

a variety of factors in addition to market shares, including barriers to entry, and whether the market in which the merged firms operated was really one susceptible to a successful cartel.

All of this, however, was a low-key prelude to the striking changes in merger enforcement that have occurred since 1980 -- that is, during the Reagan Administration. By almost all accounts, merger activity reached exceptionally high levels during the period 1981-1986, culminating in a record acquisition year in 1986. Nevertheless, in the first five of those years -- that is, 1981-1985 -- the Department of Justice brought a total of 28 merger cases. All of these cases challenged direct horizontal mergers among relatively large firms in concentrated markets, and many were settled by consent orders calling for divestiture of minor portions of the acquired firm. Government rhetoric during those years consistently praised mergers as the source of important efficiencies and criticized prior cases and enforcement as wrong-headed. Not surprisingly, the business community responded to these rhetorical invitations by proposing some of the largest mergers in history -- Mobil/Marathon, Gulf/Chevron, LTV/ Republic Steel, Sperry/Burroughs and many others.

We have seen in the past six or seven years the same sort of merger wave that this country experienced

in the 1920s -- a dramatic surge of mergers among large firms, many of them direct or near direct competitors. Like the 1920s, one reason for this surge of merger activity is the posture of the government. Its hand-off attitude and permissive rhetoric have led the business community to attempt mergers that would have been regarded as unthinkable only a decade ago.

A striking point about this major redefinition of merger policy is that it has occurred almost entirely as a matter of prosecutorial discretion. While the courts may have receded from some of the extreme interpretations of Section 7 found in cases decided in the 1960s,[4] there is no indication that the permissive enforcement levels of the past seven years reflect a consensus of judicial thinking. The same can be said with respect to Congress. Administration enforcement is not much more aggressive than merger enforcement prior to 1950 -- that is, before Congress, concerned about levels of concentration caused by mergers, amended Section 7[5]. But Congress has never repealed or even

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[4] See United States v. General Dynamics, 415 U.S. 486 (1974) suggesting that prior Supreme Court decisions in Vons and Pabst may not be good law.

[5] It is difficult to compare cases or enforcement policies in different periods of time. It is interesting, however, that Congress was led to amend Section 7 in 1950 in part because of dissatisfaction with the result in United States v. Columbia Steel Co.,

[Footnote continued on next page]

reconsidered the action it took in 1950 in tightening the merger laws. Thus, what we see in the last seven years in terms of actual enforcement (as opposed to what various sets of guidelines proclaim) is a major departure from the amendments to Section 7 that Congress adopted in 1950.

During the remainder of my testimony, I will address three questions that bear upon the oversight function: first, the adequacy of the current Department of Justice Guidelines; second, enforcement activity under the Guidelines; and third, two specific proposals for modification (and relaxation) in merger enforcement. In general, my view is that merger enforcement over the last six or seven years has been too lenient. Nevertheless, there are a few areas where the goal of competitive markets and consumer welfare could profit from a relaxation of current restrictions.

1. The DOJ Guidelines. The 1982 and 1984 Department of Justice Merger Guidelines are impressive achievements. While I believe in several respects that

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[Footnote continued from previous page]
334 U.S. 495 (1948) where no violation was found when U.S. Steel acquired a larger competitor. In that case, competition foreclosed in the vertical line was about 3%, and in the horizontal line, the merging parties accounted for 13% and 11% in a moderately concentrated market. Thus, there is a good chance the present Administration would not even have challenged the merger at issue in Columbia Steel.

they are too lenient and confusing, they retain a commitment to the essential theory of merger enforcement -- that undue concentration will lead to the joint exercise of market power and eventually the exploitation of consumers -- and they do not adopt a wildly permissive stance.

There are some problems with the Guidelines, however, which, in my opinion, have led to errors in enforcement policy.

a. Measuring Approach. The Guidelines are long and intricately formulated. As a result, I suspect there are few businessmen who have a clear idea of how the Guidelines apply to business transactions and an increasing number of specialists -- lawyers, accountants and economists -- who make a career out of interpreting these esoteric rules. Antitrust has long been a province of the specialist, but these Guidelines reinforce that tendency.

One reason for this is the key measuring device that the Guidelines adopt. All agree that market concentration -- the number of sellers competing in a market -- in an important factor in merger enforcement. All other things being equal, a given merger is more likely to create market power or impair competitive opportunities if concentration is "high" rather than "low." Prior to 1982, concentration was generally

measured by asking what number of firms accounted for what percent of the market -- i.e., four-firm concentration of 50% was regarded as "moderate" and therefore indicative of the beginning of competitive problems. The test was straight-forward and comprehensible.

The Guidelines adopted the so-called Herfindahl-Hirschman Index ("HHI") which involves the summing of the squares of individual market shares of firms included in the market. This test was adopted because it supposedly describes not only the position of the top firms in the market, but also gives a sense of the composition of the market beyond the top firms. The result is a new set of numbers summing the squares of market share of the firms in the market (for example, an HHI between 1000 and 1800 is regarded as "moderately concentrated") and the appearance of a kind of scientific accuracy in measurement.

In fact, the HHI approach adds little but complexity to the analytical process. The same result as that developed by Professors Herfindahl and Hirschman could be achieved by retaining the traditional (and more comprehensible) market share approach -- i.e., the top four firms have 50% (or 60% or 80%) of the market, but adding that there are four (or five, or six) other small firms that are competitively significant. Not only

would the same information be marshalled, but the implication of scientific certainty wrongly imputed to the HHI would be avoided.

In addition, because of the squaring approach, the HHI test exaggerates greatly levels of concentration where there are two or three relatively large firms in the market. For example, assume a market in which the top three firms have 10%, 15% and 20%, respectively, and there are four or five firms with 5% each. That falls below 1,000 on the HHI scale and the top three firms can acquire almost anyone, as long as they don't try to merge among themselves. In a second market, assume the top three firms have 10%, 20% and 25% -- and again there are four or five firms with 5% each. This falls in the area of moderate concentration and mergers will be examined rather closely. Finally, assume a third market in which the top three firms have 15%, 25% and 30% each and the same four or five firms account for 5% each. Now we are in the stratosphere and the top three firms can make no acquisition whatsoever. Of course, these three markets exhibit different levels of concentration, but it does not seem they are so radically different as to call for <u>per se</u> legality in market 1, and presumptive illegality in market 3. They only appear different because of the magnified effect of squaring large as compared to small numbers.

b. Complexity. The Guidelines are difficult to use, and undermine the goal of predictability, because of the array of factors that are incorporated in their application. The temptation to be thorough and comprehensive is understandable. Also, the Supreme Court in its 1974 decision in United States v. General Dynamics Corp.[6] emphasized that in merger enforcement, market shares and concentration levels are only the beginning of analysis. The Court appeared to be saying that many other qualitative factors need to be taken into account.

But the present Guidelines have carried this trend to an indefensible extreme. They appear to embody every economic complexity, and in the process, produce a set of rules almost impossible to administer. Not only do they require market power measurement, calculation of market shares and examination of concentration levels -- the indicators relied on in the 1968 Guidelines -- but then go on to inquire in great detail about entry conditions, the nature of the product and its terms of sale, information about specific transactions and buyer characteristics, conduct of firms in the market, market performance, and efficiency and failing company considerations.

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[6] 415 U.S. 486 (1974).

To take just one example of undue complexity, the Guidelines propose examining market performance by looking at levels of profitability and whether those levels exceeded the risk of firms in comparable industries. I do not suggest that such factors are never relevant in merger analysis. I do suggest that most cases can be decided correctly without an analysis of comparative profitability, and that these factors, like many others in the Guidelines often are susceptible to manipulation by lawyers and other consultants.

This is not the place to attempt to draft an alternative set of Guidelines. Briefly, however, I would suggest that the whole guideline process should focus on market share and concentration data, adding only an examination of entry barriers, efficiency considerations, and a failing company defense. I believe that process would provide adequate guidance to businessmen 95% or more of the time. The more elaborate structure of the current Guidelines was adopted in an honest effort to assist predictability, but they raise so many complicated and difficult factual issues that reliable predications are more rather than less difficult to make.

c. Speculative Evidence. In merger enforcement much depends on the answer to the question whether, if the combining parties raise price, they will

lose a great deal of business to others. If they will, the combined firms have little market power. There are two ways of addressing that question. One is to ask whether buyers in the past actually did shift to other products or competitors when prices increased. A second is to ask hypothetically what would happen if prices increased -- that is, ask a series of questions about possible future behavior that has not occurred.

Both types of evidence are legitimate and instructive, but there is a difference in the quality of evidence. Past pricing patterns are a matter of proof about what happened in the real world. As a practical matter, hypothetical price moves and reactions will be examined through the testimony of economic experts, and testimony -- pro and con -- of interested witnesses.

The Department of Justice Guidelines, reflecting their economic roots and theoretical outlook, are essentially indifferent to the quality of proof question. Opponents and defenders of mergers are invited by the Guidelines to speculate on what would happen if the merger led to an increase in price. In response to the merger, would foreign producers expand competitive activities in the U.S. market, would existing manufacturers of slightly different products shift over in response to price increases, would new investors enter the market?

As I will show, Department of Justice merger enforcement has been more lax than its Guidelines would indicate. I suggest that one of the main reasons has been a willingness to accept arguments about how the market will adjust to possible future price increases, deciding most close questions in favor of the transaction. Often the market will adjust, but evidence to support that should be more than hopeful predictions by people who have an interest in seeing the merger go through.

2. Enforcement. As noted, both the 1982 and 1984 Department of Justice Merger Guidelines are lenient but respectable restatements of merger enforcement policy. They cover horizontal, vertical and conglomerate mergers, retain the structural premise of merger enforcement (i.e., high concentration leads to anticompetitive effects), and in the horizontal merger area, indicate that serious concern about mergers begins where the four-firm concentration is 50% (HHI of about 1000) and becomes extremely serious when four-firm concentration is 70% (HHI of about 1800).

But enforcement during recent years is another matter.

Though vertical and conglomerate mergers are covered by the Guidelines, I am not aware of a single

Department of Justice case challenging anything except a direct horizontal merger.

With respect to horizontal mergers, the Guidelines assert that where a post-merger HHI is below 1000, mergers will rarely be challenged. Where the post-merger HHI is above 1800, mergers likely will be challenged if the merger resulted in an increase of 50 HHI points and almost always will be challenged if the merger resulted in an HHI increase of over 100 points. In the zone between those two extremes -- that is between 1000 and 1800 -- both the '82 and the '84 Guidelines stated that the Department was "likely" to challenge those mergers resulting in an increase of more than 100 HHI points.

In fact, enforcement reality bears little resemblance to the Guidelines. Since the 1982 Guidelines were published, the Department has not brought a single case in which the HHI was less than 1800.[7] In the zone above 1800, the Department has occasionally but by no means invariably challenged

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[7] There were two complaints involving HHIs below 1800, but both involved alleged violations in multiple markets where at least one of the markets included an HHI above 1800. These figures about current enforcement come from Leddy, "Recent Merger Cases Reflect Revolution in Antitrust Policy," Legal Times, page 17 (November 3, 1986).

mergers, and has rarely challenged them where the HHI was only a few hundred points above 1800.

In sum, then, we have a merger enforcement policy exclusively directed toward horizontal mergers, and even there, concerned only with mergers that occur in markets exhibiting extreme high concentration. In the moderately concentrated zone, where the four-firm concentration is between 50 and 70% and where the courts have regularly indicated a concern about competitive impairment,[8] the Administration effectively has abandoned enforcement of its own Guidelines.

3. Some Proposals. I see nothing wrong with Section 7 as it came to be interpreted in the 1970s, and certainly no need for a major legislative overhaul. Unfortunately, the law today, as enforced, permits extreme concentration of industrial assets in the United States.

That problem could be solved in large part by an enforcement stance more consistent with the Department's own Guidelines.

Oddly, in a period in which enforcement is so permissive with respect to mergers, there are two areas

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[8] See, e.g., U.S. v. Philadelphia National Bank, 374 U.S. 321 (1963); U.S. v. Continental Can Co., 378 U.S. 441 (1964). HHIs for those mergers are calculated in Handler, Blake, Pitofsky, Goldschmid, Trade Regulation, p. 966 (1983).

where a more lenient or flexible approach might serve the national interest:

a. Distressed Industries. As international trade intensifies, there are more frequent situations in which U.S. firms, or entire U.S. industries, find themselves with extreme overcapacity because of inroads from foreign imports or other international trade conditions. Eventually those firms are threatened with severe losses and even bankruptcy. In some situations, the most efficient way for firms or industries to contract is through mergers or joint ventures. For example, several firms may own several plants, all operating at less than minimum efficient scale. Through a merger or joint venture, the enterprise can close the inefficient plants and combine the complementary advantages of those plants they keep open. Workers at the closed factories can be given an opportunity to relocate within the new combined enterprise.

Some mergers and joint ventures, designed to adjust to foreign trade, may be illegal unless the antitrust laws take distressed industry conditions into account. The United States is one of the only industrialized nations with antitrust programs that fails in antitrust enforcement to consider "distressed industry" conditions as a factor in enforcement. Under

our laws, until a firm is a "failing company" -- that is, until it is virtually in the hands of the bankruptcy court -- no special exceptions are allowed.

It seems to me the Guidelines should be adjusted in this respect, at least to the extent of including industry conditions as a factor in close cases. In most situations, cartels are difficult to run in these distressed industries, in part because of the presence of vigorous foreign competition which caused the overcapacity in the first place. An antitrust system which allows U.S. industry to adjust efficiently to import challenges is in the national interest and a sensible reaction to the realities of a global market.

b. Efficiency Defense. Arguments by conservatives to adopt more lenient merger rules are often put forward on grounds that aggressive merger enforcement prevents firms, and the economy generally, from achieving maximum levels of efficiency.

There is no evidence whatsoever that the American economy generally performs at less than optimum levels because merger enforcement has blocked efficient mergers. Even if it were true that some merger enforcement prevents firms from achieving their most efficient levels of operations, the answer would be to adopt a specific efficiency defense, keyed to the facts and circumstances of particular firms and particular

markets, rather than an across-the-board loosening of merger restrictions. The Department of Justice Merger Guidelines rightly take efficiency considerations into account as a matter of prosecutorial discretion, but present antitrust law, controlling once a matter is taken to court, provides that claimed efficiencies are irrelevant.[9]

I see no reason why the courts, following the lead of the Guidelines, could not take efficiencies into account under present Section 7. In the joint venture area, courts regularly rely on efficiencies in deciding to apply strict or lenient antitrust rules.[10] If the courts continue to fail to do so in the merger area, this might be one place where legislative reform could be useful. Any defense based on efficiencies should put the burden of proof squarely on the party asserting the efficiencies, require that those efficiencies must be substantial, and that they not be achieveable through some reasonable alternative method (e.g., contract, joint venture, etc.). Of course, efficiencies would

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[9] That is an improvement over the situation in prior years. In two important early Supreme Court cases, interpreting revised Section 7, efficiencies were counted against the merger -- see United States v. Brown Shoe, 370 U.S. 294 (1962); FTC v. Procter and Gamble, 386 U.S. 568 (1967) -- an interpretation of Section 7 that was unnecessary in light of the language and legislative history of Section 7, and unwise.

[10] See Broadcast Music Inc. v. CBS, 441 U.S. 1 (1979).

just be one factor that might help justify a merger in an otherwise close case.

The case against an "efficiency defense" is that they are easy to assert -- indeed, they are almost always claimed by the proponents of a merger -- but difficult to establish and measure. That point is well taken. But I believe everyone would concede that there are some cases in which efficiencies are clearly present and competitively significant.

The resolution of the problem to me, therefore, is to require clear and convincing evidence of efficiencies. One virtue of that process is that firms, recognizing that they will receive more lenient treatment where real efficiencies are involved, will be more likely to seek out merger partners where those claims can be established. The result could actually be a "market" for the acquisition of companies that produce efficient results, and that in turn could benefit producers and consumers alike. It would be a welcome departure from the kind of "paper entrepreneurialism"[11] mergers, which put profits in the pockets of corporate managers, but do nothing to improve the efficiency of the firms involved or the economy.

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[11] The phrase was coined by Robert Reich, in The New American Frontier, 140-73 (1983).

Senator METZENBAUM. Thank you very much, Mr. Pitofsky.

Mr. Ong, we will be very happy to hear from you, sir. Are you speaking on behalf of the Business Roundtable?

Mr. ONG. I am, Mr. Chairman. I am appearing as Chairman of the Roundtable's Antitrust and Government Regulation Task Force.

As in the case of many other witnesses, I have submitted a written statement. In my oral remarks, I would like to emphasize three points. First——

Senator METZENBAUM. Each of your total statements will be included in the record.

Mr. ONG. Thank you very much.

I would like to emphasize, as I say, a few points: First, that there is a broad bipartisan consensus on the goals of merger policy in the country today; secondly, that, contrary to a popular impression which has been expressed by some witnesses earlier this morning, our merger laws are being enforced; and, third, that the Roundtable, for whom I appear continues to support legislation which would tend to update and improve the merger laws.

On the first point, you may recall, Mr. Chairman, it was my privilege to testify about ten months ago before the full Committee on the Judiciary in support of the administration's Merger Modernization Act, then S. 2160. A number of distinguished people were also heard in support of that bill, and a number of distinguished people took the other side.

The thing that impressed me, however, in that testimony was the fact that while opinions differed on that individual bill, there was a very strong consensus on the need to encourage efficiencies in U.S. business and to recognize that need in reviewing mergers, and I think you would agree that that consensus is again observable in the testimony that we heard this morning from virtually every witness.

This consensus is particularly remarkable when you consider that 25 years ago the antitrust laws, particularly those dealing with mergers, were applied in a spirit that was affirmatively hostile to efficiencies. Very few people I think today would care to defend those decisions of the sixties. It was perverse to attack enterprises for their efforts to improve efficiency then, and I think we certainly cannot afford such perverse antitrust enforcement in today's competitive environment.

Senator METZENBAUM. I do not think that there is any difference in the Congress as to the matter of real efficiencies. I think that there is a concern, as you well know, about the impact on the consumer and the impact upon competitors. I did not mean to interrupt you, but I did want to make it clear.

Mr. ONG. Well, I agree with you, I detect no difference of opinion and I think it demonstrates that we have come a considerable way in the last couple of decades.

I was also interested, Mr. Chairman, to hear you bear witness in your opening comments to the effect that the evolution of sensible approaches to antitrust law which, among other things, respect efficiencies, has not been a partisan issue in past years but has grown up in both Republican and Democratic administrations and control of the Houses of Congress by both parties.

The present consensus on goals evolved slowly. I think as we focus today on the current state of merger enforcement, it is useful to keep that history in mind. I am sure that those of us who are testifying are going to disagree on some things, but we obviously agree on many more and I think that is important.

Secondly, I would like to assert—and this, of course, is a point on which we will differ—that the merger laws are being actively enforced today. A number of witnesses have cited statistics on the number and size of mergers in recent years or the number of lawsuits compared to the number of premerger filings in an effort to demonstrate some lack of enforcement.

From my perspective, however, as a businessman and participating in the system in that capacity, a decline in litigated cases may simply mean that counsel are able to advise their clients more accurately under the current system. In an effort to avoid litigation, I certainly myself rely on the counsel of lawyers who are expert at merger law and my colleagues throughout the American business community I am sure do the same thing.

If counsel's advice on a particular proposed merger or merger idea is negative, very often that deal does not proceed. It dies and thus does not become a statistic and you never hear anything about it.

The accuracy of counsel's advice has dramatically improved as a result of merger guidelines as they were initially propounded in 1982 and revised in 1984. The lawyer who counsels his client on a particular transaction can look at the myriad of facts in a more organized way under the guidelines than would have been possible before they were enacted. They are less likely to make mistakes in their predictions and their advice.

I think if the merger law itself were brought up to date, as the Merger Modernization bill attempted to do, the accuracy of those predictions would become even further improved.

I would add that the Hart-Scott-Rodino pre-merger processes have also contributed I think in a very substantial way to a less confrontational relationship between enforcement authorities and the business community over the past ten years.

The people in the two agencies who handle the pre-merger filings have certainly viewed this process as educational, rather than an inquisitorial kind of process. They have taken their confidentiality obligations very seriously and as a result I think the business community has a very high level of confidence in that process. The process fosters compliance with the law; it reduces litigation.

Moving on to my last point, I would like to say again that the Roundtable did support the Merger Modernization Act and we continue to support it in the repackaged form before this Congress. We do so because we believe that the bill would enhance predictability by codifying the approach which courts currently use when evaluating mergers.

The operative language of the merger law is now more than 70 years old (Clayton 7). The worldwide market place has changed very dramatically since that Act was passed and there have been corresponding advances in economic understanding. We think it still makes sense to bring the law up to date and that it does not

really speak to the question of codifying any perceived lack of enforcement ardor on the part of the administration.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF THE BUSINESS ROUNDTABLE
ON MERGER-LAW ENFORCEMENT

BY JOHN D. ONG

BEFORE THE ANTITRUST SUBCOMMITTEE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

My name is John D. Ong and I am Chairman and Chief Executive Officer of the BFGoodrich Company. I appear today on behalf of The Business Roundtable, in my capacity as Chairman of the Roundtable's Antitrust and Government Regulation Task Force.

The Business Roundtable is an association of about 200 chief executive officers of substantial companies that are widely dispersed by geographic locations and by category of business. The companies represented in the Roundtable are substantial producers and purchasers of goods and services, and therefore have a vital interest in effective enforcement of the antitrust laws. The Roundtable companies also operate in a worldwide marketplace, characterized by increasingly strong competition from foreign enterprises, and they are under constant pressures to improve efficiency. It is therefore imperative that the antitrust laws be enforced in ways that enhance, rather than detract from, efficiency. This is particularly true of the laws that regulate mergers.

I. There Is a Consensus Today that the Merger Laws Should Not Interfere with Efficiency

It was my privilege to testify ten months ago before the full Committee on the Judiciary in support of the Administration's Merger Modernization Act, then numbered S. 2160. 1/ A number of distinguished people were also heard in support of the bill, and a number of distinguished people took the other side. The thing that impressed me, however, was not the fact that opinions differed on an individual bill. Rather, I was struck by strong consensus on the need to

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1/ See Merger Law Reform: Hearings on S. 2022 and S. 2160 Before the Senate Committee on the Judiciary, 99th Cong. 2d Sess. 114 (1986) (Statement of John D. Ong).

encourage efficiencies in U.S. business. Some witnesses took the view that particular standards in the bill were inappropriate, and some questioned whether legislation was necessary, but we all seemed to agree on ultimate goals. Everyone agreed that improved efficiencies are important policy objectives.

This consensus on objectives is a remarkable accomplishment. Twenty five years ago, the antitrust laws -- particularly those that deal with mergers -- were applied in a spirit that was affirmatively hostile to efficiencies. Mergers that were thought likely to produce a "competitive advantage" were suspect, and that was just another way of saying that it was illegal to seek efficiencies. I made specific references to some misguided decisions of the 1960's in my testimony last year, 2/ and I won't repeat them here. The point is that very few people would care to defend those decisions today. It was perverse to attack enterprises for their efforts to improve efficiency, and we cannot afford such perverse antitrust enforcement when we are experiencing a deterioration of our industrial base and facing increased competitive pressures from all over the world.

It is also important to remember that the evolution of sensible approaches to antitrust law has not been a partisan issue. The present consensus developed during the administrations of five Presidents from both political parties. For example, the 1968 Merger Guidelines, issued during the Johnson Administration, were unduly strict by today's standards -- as their principal author, Prof. Donald Turner, has acknowledged many times -- but they did attempt to set forth a coherent intellectual rationale for decision in a field that had previously been suffused with populist emotion.

Similarly, the Hart-Scott-Rodino amendments to the merger law, which were passed by a Democratic Congress and

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2/ Id. at 115-16.

signed by a Republican President in 1976, have made an important contribution to sensible merger enforcement. Many of us in the business community opposed those amendments because we were afraid that the procedural weapons of bureaucratic delay would be turned to a substantive purpose and used to obstruct mergers. We were wrong. The people with responsibility for implementing the law have generally done their jobs in a responsible and efficient way, and the law has probably contributed to a more informed and analytical policy toward mergers. The antitrust authorities have the opportunity to learn the business facts before they file a lawsuit, instead of the other way around.

As we focus today on the current state of merger enforcement, it is useful to keep this history in mind. I am sure that those of us who testify today will disagree on some things, but I am also sure that we agree on many more things. We all recognize that U.S. industry no longer enjoys a uniquely advantageous position in the world, and we all recognize that the challenge of overseas competition requires U.S. industry to be as efficient as possible. In that spirit, I would like to address some particular issues of concern to this Subcommittee.

II. The Merger Laws Are Actively Enforced Today

Some witnesses have cited statistics on the number and size of mergers in recent years, or on the number of lawsuits compared to the number of premerger filings, in an effort to demonstrate that the merger laws are not currently enforced. Others can discuss those statistics in detail and cite specific examples of cases that have been brought or modifications that have been negotiated. Let me just contribute the perspective of a businessman who is affected by the merger law and who attempts to comply with it.

From my perspective, antitrust litigation is always a disaster, regardless of the outcome. In an effort to avoid litigation, I rely on the counsel of lawyers who are experts on merger law, and my colleagues in the business world do the same

thing. The lawyers' advice is likely to be decisive. If their advice is negative, the deal doesn't proceed any further, it does not become a statistic and you never hear anything about it. In recent years, the accuracy of counsel's advice has dramatically improved.

The Merger Guidelines, which were published in 1982 and revised in 1984, have made a substantial contribution to antitrust law enforcement. They begin with a quantitative assessment, but also require a case-by-case analysis of the facts. They set forth in detail the analytical framework within which the facts of a particular case should be considered. The lawyers who must counsel on a particular transaction can look at the myriad facts in a more organized way than they ever could before. They are less likely to make mistakes in their predictions. If the merger law itself were brought up to date, the accuracy of these predictions would be further improved.

Moreover, the effectiveness of the Hart-Scott-Rodino premerger notification process has been enhanced by the practice of negotiating solutions or "fixes" of specific competitive problems raised by a prospective merger. Some of these ad hoc solutions are publicly announced, and we hear about them; others are not, and we don't. Either way, the law is enforced more precisely and efficiently. Some critics have complained that this process looks like regulation, rather than law enforcement, but that argument does not make sense to me. I do not see why it is less "regulatory" for a prosecutor to scuttle an entire transaction because of disagreement with a small part of it, or alternatively to engage in expensive litigation and then negotiate the appropriate relief. For many years, thoughtful people with varied political views have advocated a more cooperative, less confrontational relationship between the government and the private sector, and this is a good example of it.

I would add, parenthetically, that the less confrontational relationship that has prevailed for the last ten years by the people who handle pre-merger filings in both

antitrust agencies has been critical to the success of the Hart-Scott-Rodino law. As I indicated above, these people have viewed the filing process as an educational, rather than an inquisitorial enterprise, and they have terminated inquiries early if no competitive problems appear. They take their confidentiality obligations very seriously and they will not supply information to people who may have an agenda that differs from federal policy. As a result, the business community has developed a high level of confidence in the process, and companies frequently volunteer pertinent information without the need for a formal request. The process fosters compliance with the law and reduces litigation at the same time.

It is true that people have quarreled with particular decisions to attack or not attack a merger, and some have complained that particular negotiated solutions were not really adequate or imposed undue hardship. I am not here to defend every single merger decision of recent years; I do not know the facts of these cases and I doubt that any other outside observer does either. I have been intensely involved for over 25 years in the affairs of the BFGoodrich Company, and I can assure you that it is sometimes very difficult to determine the impact of a particular transaction involving my own company. I will not presume to offer opinions on the transactions of others.

III. Government Has to Evaluate Individual Mergers on Their Individual Competitive Merits

Much criticism of current merger enforcement has been predicated on the argument that some mergers have turned out to be mistakes. Some corporate marriages undoubtedly have been ill-advised, and there have been well-publicized divorces. But, this does not mean that the standards for evaluating mergers should be changed. The merger law requires an assessment of likely anti-competitive effects, and the prospects for offsetting efficiencies may be significant if there is some reason to believe that those effects may occur.

If no anti-competitive effects are foreseeable, however, government prosecutors do not, and should not, have the power to block mergers just because they believe the parties may be making a mistake -- much less because other parties have made mistakes in the past.

Our free enterprise economy is based on the idea that economic initiatives come from private parties who are free to act within the constraints of the law. Private parties do not have the burden of convincing regulators about the wisdom of what they intend to do. Government is normally neither authorized nor qualified to make these judgments.

Human beings will always make mistakes and no human institutions can prevent them. But, mistakes of omission are just as serious as mistakes of commission; they are just less visible. A merger that turns sour is easy to see, but beneficial mergers that will never take place if law enforcement is too restrictive go largely unknown.

Our economy will become progressively less efficient, and the living standards of our people will inevitably decline, if dynamic change is discouraged. Preservation of the status quo is not an appropriate role for antitrust; for one thing, the rest of the world will not just stand still.

Similarly, it is not appropriate to change the standards for any particular merger just because a lot of other mergers are undertaken. Merger activity in this country ebbs and flows for a variety of reasons that have very little to do with antitrust enforcement. The last great wave of mergers occurred in the late 1960's when the merger laws were more rigorously enforced than they have been in any other period of our history. Private parties are entitled to have their individual transactions examined on their individual competitive merits, regardless of what others may be doing for their own reasons. Overall statistics on merger activity therefore do not provide the basis for a valid critique of merger enforcement policy.

IV. The Roundtable's Position on Recent Legislative Proposals

As stated above, the Business Roundtable supported the Merger Modernization Act (S. 2160) that was submitted by the Administration to the last Congress, and we continue to support it in its repackaged form (S. 635; H.R. 1155 §§ 4141-42). We do so because we believe that the bill would enhance predictability by codifying the approach which courts currently use when evaluating mergers. The operative language of the merger law (Clayton Act § 7) is now more than seventy years old; it expresses concepts that are internally inconsistent and confusing to courts. The worldwide marketplace has changed dramatically since the Act was passed, and there have been corresponding advances in economic understanding. It makes sense to bring the law up to date.

There really is little dispute about the importance of the various factors that the bill sets forth for the evaluation of mergers. The basic fear seems to be that passage of this bill, or something like it, would bind future administrations to the law enforcement policies of this one. That is not so. The concepts set forth in the bill were not invented by this Administration; they have been discussed in the economic literature and applied in judicial decisions for many years. The factors for decision are set forth in neutral language; they do not compel any result; and different prosecutors and different courts may well weigh them differently. By passage of this bill, Congress would simply endorse a reasoned and structured approach to merger law enforcement; it would not thereby endorse the views of any particular enforcement authority.

While on the subject of legislation, I would like briefly to address the so-called "hostile takeover" problem. It has been suggested that members of The Business Roundtable, as chief executive officers, display more concern for their own welfare than for the public interest when they call attention to some adverse consequences of some takeover tactics. The criticism is a strange one, when it emanates from people with powerful self-interests of their own, and I do not believe that

a policy discourse is advanced by attacks on other people's motives. If views expressed in a policy debate are automatically discounted because of some perceived self-interest, it simply means that the views of the least informed are likely to be given the greatest authority.

Moreover, as stated repeatedly here and elsewhere, the members of The Business Roundtable favor a dynamic approach to merger policy. We believe that companies should be permitted to merge in the absence of demonstrated anticompetitive prospects. We do not oppose hostile takeovers, and we do not recommend that this Congress modify the antitrust laws to create different substantive for hostile takeovers. We are opposed, however, to the manipulative practices and abuses that have been coincident with so many takeovers in recent years. These practices and abuses not only drain the equity out of target companies and leave them fragmented or saddled with debt; they also undermine the basic integrity and credibility of our securities markets.

We recognize there are special problems associated with the hostile takeover phenomenon. We recognize too that some of these problems have become more acute in recent years. But these are securities problems, not antitrust problems. We believe the appropriate solutions are modifications in the securities laws that will protect the interests of shareholders and remove incentives for market abuses.

I emphasize again that we are not seeking a special measure of security in a changing world. The worldwide competitive environment is a risky environment; consolidations have occurred in the past and will continue to occur; new competitors will appear in our markets; and some companies will fade away and eventually disappear. The antitrust laws permit these changes, indeed encourage them, and the merger laws should not be enforced in a protectionist spirit.

Conclusion

In closing, I would like to stress once more that there are many things on which we all agree. Efficiency is no longer an ugly word in discussions of antitrust law generally, and merger law particularly. There is a surprising consensus about the appropriate standards for decisions in merger cases. Even though considerable concern has been expressed about the level of merger activity, there have not really been extensive arguments about the competitive effects of particular mergers -- and the antitrust authorities have to consider mergers individually. Moreover, there has been no demonstration that the very large mergers of recent years have led to an undue concentration of companies in U.S. industry. In fact, large U.S. companies are being overtaken by foreign competition in one industry after another.

Antitrust laws will serve our nation well if they are legislated and enforced with a pragmatic spirit. We know a lot more about mergers than we did twenty-five years ago; enforcement policies in various administrations have reflected that knowledge; and our economy is stronger for it. No doubt there will be changes in focus or emphasis as time goes by, but I hope that these changes do not become partisan issues. We need to preserve our present consensus about the critical role of business efficiency if U.S. industry is to survive in a fiercely competitive world.

John D. Ong

Senator METZENBAUM. Thank you very much, Mr. Ong.

Mr. Gellhorn?

Mr. GELLHORN. Thank you very much, Mr. Chairman. I have submitted a statement for the record, and in response to your request to stay within 5 minutes, I will discard my prepared remarks and focus on the three questions that have been considered this morning.

The first is whether or not the antitrust laws, in particular the merger laws, are being enforced vigorously; the second is whether this merger enforcement policy is correct; and the third is what is the appropriate role for the Justice Department and the Federal Trade Commission in enforcing merger policy. Let me respond to each quickly.

The assessment of the vigorousness of the enforcement is very much a question of where you start. When compared with the policy of the 1960s and perhaps the early 1970s, the enforcement record today does not appear to be vigorous. However, as Dean Pitofsky has I think accurately said, the policy of the 1960s and the early 1970s was seriously misguided. We saw the Supreme Court approving merger actions that sought to roll-back the supermarket revolution by stopping two small grocery chains in Los Angeles from merging, even though they had less than 8 percent of the market.

During that period we had numerous examples of almost mindless enforcement of the antitrust laws. This approach was roundly criticized as unsure and unsound. And the Supreme Court abandoned that approach, when in the mid-1970s, in the *General Dynamics* case, it began to articulate a new standard.

We have, in other words, come a long way in the development of the merger law. Along the way, our economic understanding of the operation of the marketplace has changed. The old structure-conduct-behavior-paradigm, which was the intellectual foundation of antitrust in the sixties, has been essentially abandoned. It has not been replaced by a new orthodoxy but, rather by a new skepticism.

The second point is that we have moved in the right direction. Take, for example, the record of merger enforcement in such industries as banking and beer in the sixties and seventies, where virtually every merger in this arena was challenged.

When such agencies as the Federal Trade Commission in 1979, then led by Commissioner Pertschuk and participated in by then Commissioner Pitofsky, studied the effect of merger law enforcement on the beer industry, it concluded that that merger law enforcement was not beneficial, that in fact it had been ineffective. The overly strict enforcement sought to stop technological change, without any desirable effects. The only result was that we increased worker dislocation by preventing companies from merging and obtaining more efficient plants. Instead, we forced new plants to be built and cut-off modernization of old plants. And that study by the Commission staff roundly criticized what occurred in the beer industry.

We learned in the 1970s that the ability of government to anticipate markets, to identify what is going to occur does not exceed that of the businessman. Now, I would not suggest that just because two companies merge that the businessmen necessarily know

that this is desirable. But the discipline of the marketplace is far better, far more resilient, far more able to anticipate consequences than government.

Government operates very slowly. There is an old saying by a French premier about planning which is quite applicable here, and that is that government regulation is the substitution of error for chance. We ought not to encourage that error.

It does not mean that government has no role. Government has a role in antitrust, but it is a role that should be steeped in skepticism. It is a role to intervene only where there is some substantial evidence of a likely clog in the marketplace.

This is not to say that errors have been made in current enforcement actions. For example, I would strongly criticize the approval of mergers that allowed one company to get 80 percent of the gates and slots in Minneapolis and in St. Louis recently in the airline industry. But these two mergers were opposed by the Justice Department; they were approved by the Department of Transportation. Nonetheless, it is far better for government to be cautious in antitrust than to return to the terrible days of the sixties which may have disadvantaged the American economy.

Ultimately what we are talking about is the standard of living of the American worker. A too-rigorous, constrictive, restraining antitrust policy does not serve the consumer or the American economy.

Thank you very much.

[The statement follows:]

STATEMENT OF
ERNEST GELLHORN */

Before the

Antitrust, Monopolies, and Business Rights
Subcommittee of the Senate Judiciary Committee

OVERSIGHT HEARING ON MERGERS

March 11, 1987

*/ Regional Managing Partner, Jones, Day, Reavis & Pogue, Washington, D.C. The exceptional assistance of Kathryn M. Fenton, Esq. in the preparation of this testimony is gratefully acknowledged.

I appreciate the Subcommittee's invitation to participate in today's oversight hearing on merger policy. For the vast majority of Americans, merger enforcement is perhaps the most visible aspect of antitrust policy. Those who have never heard of the "Chicago School" or the Robinson-Patman Act or vertical restraints are nonetheless familiar, from daily newspaper headlines and network news reports, with merger activities ranging from friendly acquisitions to bitter takeover contests. Mergers directly affect individual lives as workers' jobs are created or disappear, shareholders' wealth is increased or decreased, and consumers' purchasing choices are expanded or contract. Similarly, merger policy is important to our national economy as it affects the structure of American business and its ability to respond to economic change, thereby influencing America's overall competitiveness in world markets.

Because of the importance of and popular interest in merger policy, however, an examination of this issue is prone to overly simplistic analysis and the potential for demagogic appeals. This danger appears to have surfaced in the recent debate concerning the current merger policy of the Department of Justice and the Federal Trade Commission. According to some, the only merger rule currently being applied is "anything goes." Critics point to the absolute number and dollar value of recent mergers and claim that the alleged lack of

investigation and challenges by federal antitrust enforcement agencies have caused the largest merger wave in the nation's history. To state that some feel the current situation represents "the end of antitrust as we have known it" is not, I believe, putting the case too strongly.

In my view, such concerns are not established. Much of the current debate over merger policy reflects nothing more than the ongoing tension between those who would impart a political and social component to the antitrust laws and those who would limit the goals of antitrust to the attainment of economic objectives.1/ This debate is far from new and has influenced merger policies over the years, as anyone familar with antitrust history will readily admit.

A sense of this history is a particularly important tool in considering merger policy, which offers a good bellweather of the tensions between political and economic goals. The passage in 1950 of the Cellar-Kefauver Act -- though not its terms -- represents something of a zenith for proponents of political and social goals, for the legislative history of the Act rings

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1/ Compare Pitofsky, "The Political Content of Antitrust," 127 U. Pa. L. Rev. 1051 (1979) and Lande, "Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged," 34 Hastings L.J. 65 (1982); with R. Posner, Antitrust Law: An Economic Perspective 20 (1976) and Elizinga, "The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?", 125 U. Pa. L. Rev. 1191 (1977).

with concerns regarding the preservation of small business and local ownership, the protection of business freedom, and the need to ensure equitable distribution of wealth. Yet, as subsequent experience has shown, while these are certainly laudable goals, they are simply not a workable basis on which to construct a nation's merger policy.2/

Much criticism of current merger policy derives from the argument that recent mergers would not have been permitted ten years ago. Again, however, an awareness of historical perspective forces us to recognize the key consideration in shaping current merger policy: we must ensure that our policy choices reflect the world of the 1980's, not the world of ten or twenty years ago. Two factors are critical in this regard. First, today's merger policy must be seen in light of the changed markets in which American industries compete, particularly the increasing internationalization of those markets. Second, increased economic learning permits a more detailed examination of the likely competitive effects of merged firms, including a greater appreciation of the

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2/ See, e.g., Baker & Blumenthal, "The 1982 Guidelines and Preexisting Law," 71 Cal. L. Rev. 311, 319 (1983) ("Economics has provided decisionmakers with an accessible intellectual calculus. . .. Sociology and political science, in contrast, have provided only generalities that are difficult to weigh when making enforcement decisions"); E. Gellhorn, Antitrust Law and Economics, Chap. IX (3d ed. 1986).

efficiencies associated with mergers, and supports a presumption against governmental intervention into business decisions regarding the allocation of resources and capital.

A careful review of past experience should therefore be the starting point for any current reexamination of merger policy. Few would now dispute that the merger policy reflected in the enforcement decisions and judicial decisions of the 1960's went too far. The merger opinions of that era were characterized by a populist ethic harkening back to a simpler age of America's industrial development and were fueled by a suspicion of business activity that mirrored other contemporaneous social trends. From today's perspective, the holding in United States v. Von's Grocery Co.,3/ where the Supreme Court found illegal a merger between two grocery chains with a combined 7.5% of retail grocery sales in the Los Angeles metropolitan area, can only be explained as an attempt to turn back the clock in the grocery industry to a pre-supermarket age.

Decisions of that era by the lower courts and Federal Trade Commission often attacked efficiency itself as anticompetitive. For example, in United States v. Ingersoll-Rand Co.,4/ Ingersoll-Rand was enjoined from acquiring three manufacturers

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3/ 384 U.S. 270 (1966).

4/ 218 F. Supp. 530 (W.D. Pa.), aff'd, 320 F.2d 509 (3d Cir. 1963).

of underground coalmining equipment because of the explicit fear that the merger would create "economies of scale" that would put other companies at a competitive disadvantage.5/ That merger policy would be employed to reduce efficiency seems simply incomprehensible today.

From today's perspective, the intellectual underpinnings of the 1960's merger policy were equally suspect, relying on what have been demonstrated to be flawed economic studies and the structure-conduct-performance paradigm, which focused on limiting concentration because of the belief that concentration gave rise to market power and excess profits which were sustainable due to market imperfections such as entry barriers. Yet as a result of generally mechanistic application of concentration principles, the intellectual basis for many merger decisions of the 1960's is virtually nonexistent. Justice Stewart's comment in Von's Grocery that he could discern no common thread uniting the Supreme Court's antitrust

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5/ Id. at 554. See also Procter & Gamble Co., 63 F.T.C. 1465, 1580 (1963) ("[W]e reject, as specious in law and unfounded in fact, the argument that the Commission ought not, for the sake of protecting the 'inefficient' small firms in the industry, proscribe a merger so productive of 'efficiencies'."), aff'd, 386 U.S. 568 (1967); Blake & Jones, "Toward a Three-Dimensional Antitrust Policy," 65 Colum. L. Rev. 422, 456 (1965) (characterizing as the "real vice" of Brown Shoe the Government's argument that the merger was a "menace" to competition because the integrated firm would have been more efficient).

opinions of that era other than "the Government always wins"6/ has been so widely quoted simply because it is so inherently correct.

Application of such a narrow and incoherent merger policy was not without its costs. These costs, however, were not immediately evident, for America entered the decade of the 1960's as the world's undisputed leader in industrial production. It thus could tolerate, if not necessarily afford, a merger policy that frustrated more efficient use of the nation's industrial resources. Over time, however, this policy laid the seeds for the decline in American productivity. When the growing internationalization of world markets eliminated the competitive cocoon American industry had previously enjoyed and American firms faced more efficient overseas producers, they found themselves hampered by a merger policy that made it comparatively more difficult to change business structures and organizations.

As a result, there was a growing awareness of the practical consequences of an unduly restrictive merger policy and demands for its correction. Contemporaneously, the "new economic learning" began appearing on the scene,7/ challenging the

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6/ 384 U.S. at 301 (Stewart, J., dissenting).

7/ See, e.g., Demsetz, "Two Systems of Belief About Monopoly" in Industrial Concentration: The New Learning (H. Goldschmid, H. Mann & J. Weston eds. 1974).

previous orthodoxy of the structure-conduct-performance paradigm. According to this analysis, concentration was more likely to reflect economic efficiency than an industry cartel. In point of fact, it appears to be unlikely that market power can be sustained except where the government creates barriers to the free movement of resources. As this method of analysis spread from a handful of academics into the mainstream of the antitrust world, it provided the ammunition to challenge earlier merger analysis decisions.

One landmark in the trend away from the populist decisions of the 1960's was the promulgation of the 1968 Merger Guidelines by the Department of Justice (under, it should be noted, a Democratic administration). The 1968 Guidelines, which provided a structured method for analyzing mergers in contrast to the previous welter of judicial decisions,8/ clearly embodied an economic approach to merger policy by stating, "The primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition."

8/ In providing this structure, as well as in the specific tests approved, the 1968 Guidelines' cut-back from the judicially developed merger standards of the 1960's. Thus, the leadership of the Justice Department reflected in the Guidelines of the 1980's has a strong precedent.

The process of shaping merger policy since 1968 clearly has been more evolutionary than revolutionary, although there were occasional sharp departures from precedent. For example, in United States v. General Dynamics Corp.,9/ the Supreme Court reversed field and ruled that a merger was not illegal merely because of high concentration levels; the effect on long-run competitiveness also had to be considered. Subsequent cases, including non-merger decisions such as Continental T.V., Inc. v. GTE Sylvania, Inc.,10/ reflected a continuing growth in judicial acceptance of economic analysis in antitrust.

Thus, the promulgation of the Justice Department's 1982 Guidelines, which provided a uniform framework for merger analysis that was unquestionably economic in focus and left no room for express consideration of social and political goals, was consistent with the development of merger policy in the 1970's.11/ As my partner Joe Sims has commented, "the basic analytical approach [of the 1982 Guidelines] was guiding antitrust enforcement decisions before [Bill] Baxter arrived at

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9/ 415 U.S. 486 (1974).

10/ 433 U.S. 36 (1977).

11/ In formally recognizing the movement away from a strict structuralist approach, the 1982 Guidelines stress the importance of defining economically meaningful markets, create "safe harbors" for some acquisitions, and emphasize the supply side of antitrust through consideration of production substitutability and ease of entry.

Justice, and it will undoubtedly survive his tenure."12/ Similarly, the abandonment of the theories of vertical and conglomerate merger enforcement was all but complete by the time the 1982 Guidelines were issued,13/ although this restatement provided a more definitive explanation of their inapplicability.

The most recent contribution to current merger policy -- the Justice Department's 1984 revision of the Merger Guidelines -- reflected the same underlying principles as the 1982 Guidelines but provided increased flexibility and discretion, particularly with respect to treatment of efficiencies. Like the 1982 Guidelines, a measure of the 1984 Guidelines' success has been the speed and frequency with which they have been adopted by the courts as decisional criteria.

While neo-populists and others may characterize the present merger enforcement standards as "anything goes," I do not

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12/ Sims & Blumenthal, "New Merger Guidelines Provide No Real Surprises," Legal Times (June 21, 1982).

13/ In the late 1960's, the Justice Department filed a number of cases challenging large conglomerate mergers on a number of grounds, including increases in aggregate concentration and potential competition. These challenges were unsuccessful, however, and after a series of adverse judicial decisions, the Department advised in 1977 that it would no longer bring some cases that fell within its 1968 conglomerate merger guidelines. See Kauper, "The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure," 71 Cal. L. Rev. 497, 498 n. 4 (1983).

believe this characterization is fair. First, there is little statistical evidence to support these claims. In recent years, the Department of Justice and the FTC have actively pursued challenges to acquisitions that raised competive concerns. As the attachment to my testimony indicates, since 1985 the federal antitrust agencies have taken action with respect to 39 proposed acquisitions, which were either formally challenged or abandoned by the parties in the face of governmental opposition.14/ This is not a record that supports the doomsayers' arguments about the "end of antitrust." Any so-called lack of enforcement is better explained by the fact that the Guidelines have successfully informed business of what the current merger policy was and how its standards were to be applied. Armed with this information (which was clearly not discernable from the maze of conflicting precedents of the pre-1982 Guidelines), businessmen and their lawyers undoubtedly considered and rejected other acquisitions that they knew would not pass enforcement scrutiny.

In my view, the present policy reflects the right kind of presumptions as a threshold test to merger enforcement. Given the current internationalization of the American economy and

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14/ This summary, which was prepared by Charles A. James, Esq., is based on a review of press releases issued by the Department of Justice and FTC and other published news reports of merger activity.

the demonstrated lack of entry barriers -- even in such basic industries as steel and automobiles -- I believe that there are relatively few markets in which the acquisition of monopoly power can be achieved or sustained. Excess capacity rather than threatened monopolization is the problem in most markets today.15/ It therefore seems appropriate that the operative presumption should be against governmental intervention into decisions regarding the deployment of business assets through merger or acquisition. There is no reason to trust the abilities of judges, governmental agencies, or even elected officials to make appropriate decisions in this regard in preference to the decisions of the business community. Indeed, to the extent that businesses operate under the harsh but effective discipline of profitability, the incentives provided by the high cost of failure may be more likely to produce a correct result from business managers than from other sources.

This is not to suggest that business decisions should be given free reign, exempt from any governmental scrutiny. Left to its own devices, what business would not seek to enjoy a monopoly over its customers? But the dangers posed by anticompetitive conduct should be addressed on the basis of

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15/ See "A Global Overcapacity Hurts Many Industries; No Easy Cure is Seen," Wall Street Journal (March 9, 1987) at p. 1, col. 6.

proven concern in particular situations, not unsupportable assumptions applied in unnecessarily broad remedies. A flexible merger policy, such as that embodied in the current statutes and guidelines, is the best way to achieve competitive result.16/

Before drawing any conclusions about the appropriate merger policy to guide the United States into the 1990's, this body should ask what level of merger law enforcement is necessary to preserve competitive markets. Too much intervention is likely to be more costly than too little since excess government action is not self-correcting. I strongly doubt that anyone wants to return to the "Government always wins" days of the 1960's.

At the same time, however, we need to ask whether there are similar (perhaps yet unrecognized) costs associated with

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16/ The role for government enforcement is likely to prove particularly important in industries newly emerging from governmental regulation such as transportation and telecommunications. In this regard, I have some concern about recently-approved mergers in the airline industry that created situations in which a single carrier controlled over 80 percent of the gates and traffic at two leading hub airports (Minneapolis and St. Louis). See TWA-Ozark Acquisition Case, Dkt. 43837, Order 86-9-29 (DOT, Sept. 15, 1986), NWA-Republic Acquisition Case, Dkt. 43754, Order 86-7-81 (DOT, July 31, 1986). It should be noted, however, that these mergers were approved by the Department of Transportation, which does not have a history of antitrust expertise, and that the Department of Justice strongly opposed both mergers before the DOT.

current merger policy. The obvious danger, of course, is the creation and maintenance of monopoly power. Yet despite the searchlight applied by opponents of the current policy, I do not believe it is possible to identify any industry that is moving toward monopolization or cartelization as a result of the DOJ Merger Guidelines. Nor do I think such a result likely, given the global markets in which American industry must compete.

This conclusion, however, will hold only if American markets remain open to the positive influences of competition from domestic or foreign firms. The biggest threat to competition is not associated with mergers or the lack of merger enforcement, but rather with trade legislation or protectionist measures that seek to insulate American firms from the competitive stimulus of foreign rivalry.

Finally, in considering merger policy, it is also important for this Subcommittee to recognize the impact of Congressional oversight on merger enforcement. Numerous studies have demonstrated the responsiveness of federal agencies to perceived Congressional wishes, even in the absence of express legislation.17/ In addition, it is probably unnecessary to

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17/ See, e.g., Clarkson & Muris, "Commission Performance, Incentives, and Behavior," in The Federal Trade Commission Since 1970 (K. Clarkson & T. Muris, eds. 1981); Weingast & Moran, "Bureaucratic Discretion or Congressional Control?

[Footnote continued on next page]

tell you how your words and actions are scrutinized and dissected by the business community and factored into planning decisions. For this reason, Congressional hyperbole on the subject of merger enforcement is misplaced and likely to prove counterproductive.

The debate between those who would impart a political and social component into the antitrust laws and those who would limit antitrust policy to a consideration of economic goals is not likely to be resolved soon. The tension between these elements is clearly seen in a review of merger policy over the past twenty-five years. That record and a recognition of the international markets in which American firms must now compete demonstrates the wisdom of the current merger enforcement policy. It further suggests that careful analysis rather than acrimonious disputation is the way to develop wise merger policy. The better course for this Subcommittee, and those who share the opportunity of appearing before it, therefore, is that we lower our voices and engage in an open dialogue as we continue to shape public policy on business mergers.

17/ [Footnote continued from previous page]

Regulatory Policymaking by the Federal Trade Commission," 91 J. Pol. Econ. 765 (1983); Kovacic, "The Federal Trade Commission and Congressional Oversight of Antitrust Enforcement," 17 Tulsa L.J. 587 (1982).

ATTACHMENT

	DATE	FIRMS	PRODUCT	AGENCY	COMMENTS
1.	01/08/85	Borden/Reichold	Resins	DOJ	
2.	01/29/85	Norfolk Southern/Conrail	Rail Services	DOJ	ICC Intervention
3.	03/06/85	Cooper/Westinghouse	Aviation Lighting	DOJ	Consent
4.	06/06/85	Houston Natural Gas/ Internorth	Gas Pipelines	FTC	Consent
5.	07/11/85	Industr. Asphalt/Huntmix	Asphaltic Concrete	DOJ	Post-Acq. Complnt.
6.	07/23/85	Olin/FMC	Swimming Pool Chemicals	FTC	Admin. Litigation
7.	07/30/85	Allied/Signal	Air Turbine Starters	DOJ	Consent
8.	08/9/85	Bell/Asarco	HSR Violation	FTC/ DOJ	Settled
9.	09/17/85	United/Pan Am	Passenger Air Services	DOJ	DOT Intervention
10.	09/20/85	Midcon/United Energy Resources	Gas Pipelines	FTC	Consent
11.	10/22/85	Atchinson-Topeka/ Southern Pacific	Rail Services	DOJ	ICC Intervention
12.	10/31/85	HCA/North Park Hospital	Hospital Services	FTC	FTC Decision
13.	11/22/85	Baxter Travenol/Amer. Hospital Supply	Hospital Equipment	DOJ	Consent
14.	12/17/85	PPG/Swedlow	Aircraft Transparencies	FTC	Injunction Granted
15.	02/19/86	Occidental/Midcon	Gas Pipelines	FTC	Consent
16.	02/20/86	Champion/St. Regis	Linerboard	FTC	Consent Withdrawn
17.	02/24/86	Terra Aqua/S.p.A.	Gabions	DOJ	Consent
18.	02/28/86	Pacific Telesis/ Communications Indus.	Cellular Radio	DOJ	Consent
19.	03/31/86	Republic/Northwest	Passenger Air Service	DOJ	DOT Intervention

	DATE	FIRMS	PRODUCT	AGENCY	COMMENTS
20.	04/3/86	Occidental/Tenneco	PVC	FTC	Injunction Denied
21.	05/13/86	Texas Air Corp./Eastern Airlines	Passenger Air Services	DOJ	DOT Intervention
22.	05/21/86	GE/RCA	Vidicons	DOJ	Consent
23.	06/20/86	John Deere/Versatile	4WD Tractors	DOJ	Conditioned Approval
24.	07/14/86	TWA/Ozark	Passenger Air Services	DOJ	DOT Intervention
25.	07/15/86	Coke/Dr. Pepper	Soft Drinks	FTC	Injunc. Granted; Deal Abandoned
26.	07/15/86	Pepsi/Seven-Up	Soft Drinks	FTC	Deal Abandoned
27.	08/25/86	Data Card/DBS	Automatic Embossers	DOJ	Consent
28.	10/21/86	L'Air Liquid/Big Three	Industrial Gases	FTC	Consent
29.	11/10/86	Rohm & Haas/Duolite	Exchange Resins	DOJ	Consent
30.	12/02/86	Kidde/Harnischfeger	Hydraulic Cranes	FTC	Deal Abandoned
31.	12/09/86	MacAndrews & Forbes/ Lorimar	Film Lab Services	DOJ	Deal Abandoned
32.	12/30/86	Conoco/Asamera	Crude Oil	FTC	
33.	12/31/86	Rheem/Bradford White	Water Heaters	DOJ	Deal Abandoned
34.	01/13/87	Domtar/Imasco	Gypsum Board	DOJ	
35.	01/15/87	American Hoechst/Celanese	Polyester Fiber	FTC	
36.	01/25/87	Hughes Tool/Baker	Rock Bits/Pumps	FTC	
37.	01/30/87	Alleghany/Safeco Title Ins.	Title Services	FTC	Consent
38.	02/05/87	Ethyl/Dow Chemical	Brominated Brine Fluids	DOJ	
39.	02/13/87	American Sterilizer/Castle	Hospital Sterilizers	FTC	Abandoned After 2nd Request

Senator METZENBAUM. Thank you.

Mr. Scherer?

Mr. SCHERER. Thank you very much, Mr. Chairman. It is a pleasure to be here.

I agree with Mr. Gellhorn that there were excesses of antimerger enforcement in the 1960s. My perspective is that of a former FTC staff member responsible for enforcement in the mid-1970s. It is true, we took a more cautious approach.

Today, mergers are getting through upon the calculated advice of counsel that surely would have been challenged by the Federal Trade Commission during the mid-1970s. There has been a relaxation quantitatively and qualitatively. Why has this happened?

I think the basic reason involves the view of the effect of mergers taken by the current administration. That view essentially holds that mergers tend on average to be efficiency enhancing.

In fact, there are sharply divided views among economists and policy people on this question. The basis for the belief that mergers are in general efficiency enhancing is two-fold. Either there is a pure act of faith, or one looks at short-run stock market reactions to mergers and concludes, because the stock prices have gone up in the short run, that the mergers must in some sense be good.

There are substantial problems in that approach, but let me take you quickly to the other side of the methodological debate. With David Ravenscraft of the Federal Trade Commission, I have been doing a study over the past 5 years trying to get at the longer-term efficiency consequences of mergers.

Using Federal Trade Commission line of business data, we evaluated the consequences of some 6,000 mergers. Clearly, some mergers are efficiency enhancing. On average, however, we found that for lines still with their new parent on average eight years after acquisition, profitability had fallen significantly relative to the level of profits pre-merger.

More importantly, we found that roughly one-third of all acquisitions, especially the conglomerate acquisitions, subsequently got undone, that is to say, they were sold off. These were clearly failure cases on average. On average, profits were negative in the year before sell-off commenced.

Mr. Chairman, eight years ago when you were Chairman of this subcommittee, you held hearings on conglomerate mergers. Numerous witnesses appeared before you telling you then that conglomerate mergers are good, they are efficiency enhancing. Now we are told by the Justice Department's Mr. Rule that what many mergers are doing today is undoing bad conglomerate mergers of the past. That is to say, what was seen as good in the past turns out now to be bad, to be efficiency reducing, and now we are having a second round of mergers to undo the efficiency reducing mergers of the past. I find this paradoxical indeed.

Again, one has to admit that some mergers can be efficiency enhancing. It is probably a minority of mergers. I think therefore that the proper policy is one first, of taking a tough a priori stance against mergers, that is to say, when there are substantial structural effects, the Antitrust Division or the FTC should intervene. But then, I believe, there should be an efficiency defense based to

the maximum degree possible on the kind of hard evidence that Professor Pitofsky would like to see.

My own experience in a couple of cases is that the Justice Department's enforcement of its efficiency criterion is capricious at best, but since my time is up, I will stop.

Thank you.

[The statement follows:]

Testimony of F. M. Scherer

before the

Subcommittee on Antitrust, Monopoly, and Business Rights

Senate Committee on the Judiciary

March 11, 1987

Few economic events have captured the public's interest in recent years like the wave of takeovers and mergers whose record-breaking quantitative dimensions I documented in testimony before the Judiciary Committee last year.[1]

Although the public is interested, it need not be concerned, we are told by the Administration. Two years ago the President's Council of Economic Advisers devoted a full chapter of its annual report to the merger question and concluded:

> The available evidence ... is that mergers and acquisitions increase national wealth. They improve efficiency, transfer scarce resources to higher valued uses, and stimulate effective corporate management. They also help recapitalize firms so that their financial structures are more in line with prevailing market conditions. In addition, there is no evidence that mergers and acquisitions have, on any systematic basis, caused anticompetitive price increases.[2]

It may not surprise the Committee to learn that what is believed in the Executive Office Buildings is not necessarily believed "out there" where the voters dwell. A recent Yankelovitch survey of 3,600 Stanford and Harvard

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1. Hearings on Merger Law Reform, 99th Congress, 2nd session, p. 79.

2. Economic Report of the President: February 1985, p. 196.

alumni is informative on this point.[3] Fifty-eight percent believed that the problem of a growing number of mergers and acquisitions [1985 was an all-time record year] was either "very serious" (18 %) or "somewhat serious" (40 %). The reasons for their concern included too much concentration of power (58 %), limited competition (52 %), and the diversion of capital from job-producing investments (44 %).

This divergence of views is paralleled within the economics profession. We economists are well known for disagreeing, but in my nearly three decades of work in the field, I have seen few industrial organization questions on which the differences were so polarized and the issues so poorly joined. One school of thought, whose views the Administration echoes, sees mergers and takeovers as preponderantly efficiency-increasing. Another school is at minimum more skeptical, and may go so far as to say that mergers in recent American history have on balance been efficiency-reducing. I belong to the latter school, and I confess as much difficulty understanding the logic of the "efficiency increase" school as they seem to have understanding mine. The problem appears to lie at three levels.

One level involves ideology. Those who see mergers as efficiency-enhancing tend also to believe that the "invisible hand" seldom goes astray. Those who are more skeptical

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3. Florence Skelly, "To the Beat of a Different Drum," Harvard Magazine, March-April 1986, pp. 24-26.

believe that the market sometimes makes serious, systematic errors that are not quickly self-correcting.

At a second level is what I see (perhaps unfairly) as a conflict between common sense and blind obsession with "the numbers." Those who stress common sense like Peter Drucker, the staff of management consultants McKinsey & Co. (which undertook a major study of mergers' success), and (I would like to believe) myself observe widespread failure in the wake of the previous merger wave that peaked in 1968. As Peter Drucker put it, two mergers out of five are "outright disasters," two "neither live nor die," and one "works."[4] My own historical research with David Ravenscraft on some 6,000 acquisitions showed that roughly one out of three (but perhaps as many as 40 percent) ended up being undone through sell-off, with negative operating income on average in the year before sell-off.[5] The "mergers are efficient" school, on the other hand, perceives conclusions drawn on the basis of case studies and trade journal accounts as "anecdotal" and therefore "unscientific." The only "scientific" way to evaluate mergers, they insist, is to analyze the numbers.

This brings us to the third level, quantitative analysis, where, surprisingly, the disagreements are sharpest of all.

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4. "Why Some Mergers Work and Many Don't," Forbes, January 18, 1982, p. 36.

5. David J. Ravenscraft and F. M. Scherer, Mergers, Sell-offs, and Economic Efficiency, book to be published in 1987 by the Brookings Institution. The research was supported by the National Science Foundation and the Federal Trade Commission as well as Brookings.

The "mergers are efficient" school bases its conclusions on studies of stock price behavior at the time of "merger events." They invoke the Efficient Capital Markets axiom to infer that how common stock investors perceive the value of a merger in the few weeks surrounding its initial announcement is the best available evidence on its long-run consequences. Those who are more skeptical of mergers' success base their conclusions in part upon longer-term statistical studies of post-merger profitability changes. Their work is in turn challenged by the Efficient Capital Markets advocates, who claim, largely on the basis of theory unsupported by systematic empirical analysis, that accounting data are unreliable and biased indicators of economic reality. The lack of empirical basis for their claim reflects a methodological Catch 22: if you do not believe in the validity of a data set, how can you rationally allocate your time to doing painstaking research with it?

As one who has spent the last four years toiling with accounting data on the precursors and outcomes of merger, I believe that the data can tell us important things about the world. But that belief is not merely an act of pure faith; it has been put to the test. In the economic theory of the firm, few things are more fundamental than the phenomena of market entry and exit. From the Federal Trade Commission's Line of Business program data set, Ravenscraft and I have compiled extremely detailed data on exits, manifested in the decision

to sell off a full line or business, or a part thereof, to some other company or into a leveraged buyout. Among thirteen variables introduced statistically to "explain" sell-off, the most powerful single predictor was individual line of business profitability. The second most powerful predictor was overall company profitability. Accounting data strongly validate the proposition of economic theory (and common sense) that the lower profits are, the higher is the exit probability. Having passed that test with flying colors, the data deserve to be taken seriously when used (carefully) to study the outcome of mergers. I shall return to our findings shortly.

First, however, I must be critical. No sensible scholar denies that accounting data are imperfect and must be analyzed with care. It is harder for stock market "event" analysts, who begin from the axiom that capital markets efficiently impound all available information on underlying company values, to admit imperfection. But serious imperfections do exist.

To put them in context, we must see how the typical "merger event" study works. Through techniques that need not detain us, the stock price trajectory of subject companies is normalized relative to general market price movements for companies of similar risk. One then analyzes the behavior of a sample of merger partners' stock prices during a narrow "window" of time -- usually three or four weeks before and after the announcement that makes investors aware a merger

will (or may) occur. The typical study shows strong price gains for the acquired entity and neither gain nor loss (with some exceptions) for the acquiring company. From this follows the conclusion: If the acquired company's shares increase in value and the acquiring company's shares change in value insignificantly, the sum of a positive plus a zero is positive, and therefore, mergers must be value-enhancing on average.

To take the next step, concluding that mergers are not only stock value-enhancing, but also efficiency-enhancing, one must rule out the alternate possibility that profit expectations improved because monopoly power was created. This is intrinsically unlikely (although not impossible) for conglomerate mergers. Two studies have addressed the question for horizontal mergers.[6] Their premise is that, if monopoly power results, prices will be raised, and the elevated price umbrella will benefit competitors too, raising their stock prices as well. The authors of the two studies conclude that the monopoly power hypothesis was rejected by their tests. However, Eckbo in fact found statistically significant stock price increases for the competitors of mergers challenged by the Department of Justice. He backpedals from this finding only by observing that competitors' stock prices did not fall

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6. Robert Stillman, "Examining Antitrust Policy Toward Horizontal Mergers," and B. Espen Eckbo, "Horizontal Mergers, Collusion, and Stockholder Wealth," both in the Journal of Financial Economics, vol. 11 (1983), pp. 225-273.

when an antitrust challenge was announced, which seems to me, as a former Federal Trade Commission economist, to underestimate the leak-proneness of antitrust agencies and overestimate the efficacy of the agencies in undoing important challenged mergers. Announcement time competitor stock price changes in Robert Stillman's sample were also positive in 10 of 12 cases, but the sample was too small to find statistical significance. Recognizing this small-sample limitation, my reading of the Eckbo and Stillman papers is that the monopoly power price-raising hypothesis received considerable support. Since this interpretation differs from that of the authors, I urge the Committee to have its able staff undertake a careful independent reading.

Wholly apart from this problem, which (given a tough antitrust policy) arises for only a small fraction of pre-1980 mergers, there are other anomalies in the stock price studies of "merger events." I cite only three of the most serious.

(1) When the period of analysis is extended from a few weeks to two or three years after the merger "event," the stock price returns of the acquiring company have exhibited a tendency to turn negative, implying that the positive returns to acquired firm stockholders may be offset by negative returns to acquiring company stockholders. The clear efficiency conclusion no longer holds, for the value of a positive plus a negative is indeterminate without more precise information. Equally

troublesome, one wonders what learning process underlay the systematic post-merger price changes. As Jensen and Ruback concede in their much-cited survey article, "These post-outcome negative abnormal returns are unsettling, because they are inconsistent with market efficiency and suggest that change in stock price during takeovers overestimate the future efficiency gains from mergers."[7]

(2) What conclusion one draws on the two- to three-year returns of the acquiring company is not free of a thorny methodological problem. The more one emphasizes pre-merger stock price behavior as a basis for projecting the post-merger benchmark, the worse the post-merger performance picture turns out to be. Even when post-merger returns are related only to trends in the stock market generally, however, the long-run negative return tendency persists.

(3) Early "event" studies focused on mergers made during the conglomerate merger wave that peaked in 1968, and studies of subsequent events show similar patterns. Yet it is clear in historical hindsight that the stock market erred massively in evaluating late 1960s conglomerate mergers. Ravenscraft and I found that the person who invested $1,000 in each of the thirteen leading manufacturing conglomerate merger-makers at their

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7. Michael C. Jensen and Richard S. Ruback, "The Market for Corporate Control: The Scientific Evidence," Journal of Financial Economics, vol. 11 (1983), pp 20-22.

peak of activity in 1968 (i.e., investing $13,000 in all) would have had a portfolio valued at only $6,828 in 1973 or $5,686 in 1974. Had the same $13,000 been invested in the Standard & Poor's industrials portfolio, the value would have been $16,145 in 1973 or $14,342 in 1974. If the market erred so badly in evaluating the five- or six-year prospects of active merger-makers in the late 1960s, what is there to ensure that it will not do so again?

An alternative to analyzing mergers' success on the basis of stock market "event" studies is to examine what happened to profits before and after merger. The 471 U.S. corporations whose Federal Trade Commission "Line of Business" data were analyzed by Ravenscraft and myself accounted for approximately three-fourths of all manufacturing and mining sector acquisitions by asset value over the period 1950-76. To the several thousand finely disaggregated lines of business (LBs) of those companies, we coded some 6,000 non-divested 1950-76 manufacturing acquisitions and attempted to identify all divestitures made between 1975 and 1981. In addition, we conducted field case studies of 15 mergers that were subsequently undone through sell-off. From the analysis of this evidence, numerous conclusions have emerged. Let me try to summarize some of the most important:

(1) As noted before, by our best estimate, one-third of the acquisitions were subsequently sold off.

(2) Our case studies revealed that the typical reason for sell-off was top management dissatisfaction with the financial performance of the acquired unit. Poor performance followed in turn from three variables, often interacting: bad luck (related in part to the turbulent business conditions of the 1970s); the inability of parents to exercise effective managerial control over their acquired units, especially when trouble appeared; and incentive breakdowns attributable to the new and more cumbersome organizational structure into which the acquired unit was fitted.

(3) Our quantitative analysis confirms that low profitability is the most important factor explaining the sell-off of acquired units. On average, in the year before sell-off, a unit to be divested had an operating income / assets ratio of minus 1 percent. Non-divested units had average returns of plus 13 percent.

(4) Contrary to popular impression, the business entities acquired were not companies in trouble, but were highly profitable before their acquisition. For a three-year sample, unweighted average operating income was 20 percent of assets in the last reporting period before merger for the acquired entities. The comparable figure for all manufacturing corporations was 10.9 percent.

(5) The profitability of acquired units surviving sell-off also dropped, but less precipitously, following

their acquisition. An analysis of the data for 2,955 lines of business reveals that on average, profitability dropped by about one-half percentage point per year following acquisition.

(6) Acquisitions of companies operating in the same broad (two-digit) industrial group and horizontal acquisitions were more successful in maintaining their profitability than purely conglomerate acquisitions. All conglomerate acquisitions had relatively high sell-off probabilities; horizontal and especially vertical acquisitions were less likely to be sold off. The only category of mergers that achieved a slight increase in baseline profitability following merger were those we called "mergers of equals," in which the two parties differed from one another in size by no more than a factor of two. We attribute these differences to differences in managerial effectiveness. More effort is likely to be put into making "mergers of equals" work, whereas when a company acquires a much smaller firm in some unfamiliar line of business, tensions are created and the parent's skills are poorly-adapted to problem-solving in the acquiree's field of operation.

(7) When I refer to "baseline profitability," I mean profitability before asset and depreciation adjustments explicitly attributable to merger are made. When one analyzes profitability on the basis of post-

adjustment magnitudes, one finds that the average acquisition was significantly less profitable post-merger than non-acquired units with similar market shares in the same industry. The rates of return achieved through merger were lower on average than those typically imposed as "hurdle rates" by large U.S. corporations in evaluating new capital investment proposals.

(8) The acquired units that were not sold off grew at least as rapidly as, and perhaps more rapidly than, the industries to which they belonged. However, they did not grow as rapidly as a control group of matched non-acquired companies comparable in pre-merger size and profitability.

(9) Lines of business with intensive acquisition histories conducted significantly less company-financed research and development in relation to their sales than LBs with no merger history, holding industry membership constant. The difference between high- and no-merger line R&D/sales ratios was 18 percent. The difference was greater for conglomerate than horizontal acquisitions, but both types showed negative R&D support effects.

In sum, our study of post-merger performance -- perhaps the largest and most ambitious U.S. merger study attempted -- indicates that mergers of the 1960s and early 1970s were on average far from a thumping success. Many ended in sell-off; for those that did not, profitability declined on average

after acquisition (except for "mergers of equals"); and R&D spending -- so important to productivity growth -- appears to have been adversely affected.

None of this denies that some mergers increase efficiency. I have seen impressive examples. In the United States, some horizontal mergers have been especially effective in improving the operations of divisions that fared poorly under conglomerate ownership. To take such mergers into account as special cases, I have long believed that U.S. merger law should include an explicit efficiencies defense. It is important, however, to put the burden of proof on the parties competent to bear it: the merger partners. This allocation of burden would, in my opinion, have an important fringe benefit. Many mergers are undertaken without careful thought as to how the two organizations will be fused effectively to ensure that efficiencies will result. By forcing managers to think out sizable acquisitions in advance, such a rule could prevent many ill-conceived, efficiency-reducing mergers. This is where the most important opportunity for merger law reform lies.

One point requires further analysis, even though it lies outside the domain of the historical research conducted by David Ravenscraft and myself. A new and striking characteristic of the current merger and takeover wave is the widespread substitution of debt for equity financing. Such "leveraging" offers significant benefits to companies

revamping their financial structures. Common and preferred stock dividends are taxable once at the corporate level and again when they are paid out to shareholders. The interest on bonds is taxed only once, at the individual recipient level. Because of this, debt tends within reasonable limits to have lower after-tax costs than equity, and by leveraging, companies reduce their average cost of capital and hence become more competitive. However, debt is also riskier, because its interest payments are contractually guaranteed. In leveraging, the company and its capital providers accept higher risk in exchange for lower tax costs. Taking risks is what capitalism is supposed to be all about, so why should Congress be concerned?

There are two answers. The obvious one is that a tax saving to the company is a loss of revenue to the deficit-ridden Federal Treasury. But more importantly, there is a subtle macroeconomic cost. Should a recession occur, heavily leveraged companies will be hard-pressed to service their debt. They are likely inter alia to cut back their investment in plant and equipment to cover their debt service needs. Such investment cutbacks generate downward multiplier effects, driving national income downward and aggravating the severity of the recession. To the extent that heavier leverage leads to deeper investment cuts during recession, innocent third parties -- the workers who lose their jobs -- bear the hidden costs. And because it is currently running such high

budgetary deficits, the Federal Government will be severely hindered in taking the appopriate counter-cyclical measures. Therefore, high leveraging of business financial structures is likely to increase the economy's future instability. This is a matter about which Congress has every right and duty to be concerned.

Senator METZENBAUM. Thank you very much, Mr. Scherer.

I do not know whether my colleague, Senator Heflin, has a statement he wishes to make or not.

Senator HEFLIN. No. Thank you, Mr. Chairman.

Senator METZENBAUM. We are very happy to have you with us.

As I think you know, I have introduced a bill which has four parts to it having to do with the Hart-Scott-Rodino part of our law, and I am going to ask each of you, if you will answer very briefly, whether you support that particular portion of the amendment.

The first one is to close the partnership loophole. Mr. Gellhorn, do you want to respond first?

Mr. GELLHORN. I have no difficulty with that proposal.

Senator METZENBAUM. Mr. Ong?

Mr. ONG. Senator, at the time that I was asked to testify, you had some hearings on your bill earlier, the Roundtable had not taken a position on the bill and so I had to decline. We have studied the bill at this point and I would hope that you will give us an opportunity sometime to testify in detail with respect to it.

However, just replying briefly to your question, we think that there is merit in closing the so-called partnership loophole. Our only concern would be that it is probably a pretty difficult technical task because if the legislation was not very carefully written it might sweep in some perfectly legitimate transactions involving partnerships, to make them more difficult, which would not be obviously the intention of the legislation.

We think it might be a good idea to look at the option of addressing that problem through rule making, but I think in principal we support the idea of closing the loophole.

Senator METZENBAUM. We are very receptive to working with you or some person representing the Business Roundtable to be certain that our language is carefully crafted. We have no intention of going beyond the specifics that we are looking at.

Mr. ONG. We would like to work with you on that.

Senator METZENBAUM. We are happy to have you.

Professor Pitofsky?

Mr. PITOFSKY. I think Mr. Ong makes a good point about the importance of attending to the details of closing the partnership loophole. I never understood why that exception was in there in the first place and I think it should be eliminated.

Senator METZENBAUM. Professor Scherer?

Mr. SCHERER. I have no problem with the elimination.

Senator METZENBAUM. I will ask you next about equalizing the time for cash tenders. As you know, with respect to cash tenders, the department has half the amount of time that they have for stock tenders. Do you have a position on that, Mr. Scherer?

Mr. SCHERER. No, sir, I do not. I have not studied it.

Senator METZENBAUM. Professor Pitofsky?

Mr. PITOFSKY. Nor do I.

Senator METZENBAUM. Mr. Gellhorn?

Mr. GELLHORN. Except insofar as it could be an impediment of opportunities for mergers which frequently are desirable, it does not seem to me to be an antitrust issue. Rather, it is a question of the regulation of takeovers and tender offers, and those are subject to some regulation. Waiting periods may operate clumsily and

therefore perhaps are an awkward clog in the marketplace. Thus, I think that one has to move very cautiously here. This may be a back-door method of controlling mergers, without focusing as the antitrust laws do on the anti-competitive consequences. That would be my concern, that your proposed regulation might have unintended and unanticipated consequences.

Senator METZENBAUM. As I see it, if you are tendering stock, you are making a merger with stock, they have more time to make the study, and all this does is say that when there is a cash tender offer that the department has the same amount of time in order to make the study. I have difficulty in understanding why anybody would have any difficulty giving the department the same amount of time, since I do not think it is—since I do not think philosophically or operationally, the department does not have to take the full time. The department can shorten the time but if the department says it needs the time, then it has the time.

Mr. GELLHORN. If it is so limited, I think my objections would be quite restrained.

Senator METZENBAUM. Mr. Ong?

Mr. ONG. I think Mr. Gellhorn has a good point, that it really seems to have more to do with securities market regulation than antitrust, but I think the Roundtable would have no problem with that recommendation.

Senator METZENBAUM. I would guess that none of you would have any problems in our proposal to eliminate filings with respect to small mergers, that small mergers below a certain dollar amount would not have to be—that they would not have to give the Hart-Scott-Rodino notice. Do any of you have any objections to that?

Mr. PITOFSKY. I think it is a sound idea.

Senator METZENBAUM. Mr. Ong?

Mr. ONG. None.

Senator METZENBAUM. Mr. Gellhorn?

Mr. GELLHORN. [Shakes head.]

Senator METZENBAUM. Let the record show that the shake of the head does not answer. The answer is no?

Mr. ONG. No objection.

Mr. GELLHORN. The only question would really be whether or not one has raised the minimum high enough and what is the appropriate dividing line. But in order to get agreement I would accept almost any level.

Senator METZENBAUM. Mr. Scherer?

Mr. SCHERER. Well, there has always been such a thresh-hold and again the question is always where you set it.

Senator METZENBAUM. But you would not be opposed to our raising that figure as proposed in our bill? I think we go from $15 to $25 million.

Mr. SCHERER. I do not consider that a major change.

Senator METZENBAUM. And how about the question that the State Attorneys General have been pressing for, access for State Attorneys General to have access to the filings?

Professor Scherer?

Mr. SCHERER. I think that would be a very valuable thing. I was briefly involved in some discussions about the Texaco-Getty

merger, and the inability to get that documentation was a major sticking point.

Senator METZENBAUM. Professor Pitofsky?

Mr. PITOFSKY. As the State AGs have a larger and larger roll to play in antitrust enforcement, and certainly that has been the case in recent years, we would all be better served if they had access to reliable information.

Senator METZENBAUM. Mr. Gellhorn?

Mr. GELLHORN. I would sharply disagree. As I read the statement of the State Attorneys General they are really harkening back to a different era. The focus of their guidelines is to seek the use of the antitrust laws to redistribute wealth, to control all distribution (particularly if one looks at their introductory materials). That I think is undesirable, is contrary to the thrust of antitrust enforcement since the mid-1970s. Much of it, of course, would depend on how those laws are in fact enforced.

There is sufficient flexibility in their statement that—perhaps it is harmless, but I do not read it that way. As a consequence, I think it undesirable to give them additional information and authority.

In addition, I think there is a serious problem, as reflected in the Supreme Court's decision in the Cargill case the last term, of allowing a variety of forces to play a major role in merger law enforcement.

Ultimately, what we are talking about here is the competitiveness of the economy and its ability to compete on a worldwide scale, and the somewhat narrower, albeit well-intentioned interests of particular State Attorneys Generals, will not give us the proper perspective on national problems, and frequently these mergers are national and international in scope. And, to have a major merger in an industry such as the petroleum industry controlled by an Attorney General of a State responsive to much narrower concerns, not badly intentioned but narrower concerns, is it seems to me undesirable.

One may disagree about the focus of antitrust enforcement, and it is appropriate to hold oversight hearings such as these and challenge it and have an open dialogue and discussion, but that kind of control, that kind of insight, that kind of public spotlight is not available at the State level and I would suggest that the activities of the State Attorneys General on vertical restraint guidelines, on horizontal merger, the Robinson-Patman Act, in recent weeks, months, and years does not well serve the competitive status of the American economy.

Senator METZENBAUM. Mr. Ong?

Mr. ONG. The Business Roundtable would be very much opposed to that provision of the bill, Senator, and I think essentially the reason is this: As I mentioned in my testimony a few moments ago, it is our conviction that the Hart-Scott-Rodino process has really been a very successful addition to antitrust law enforcement in this country and has helped to make enforcement more effective, to make advice to business firms by lawyers more precise and predictive in nature, and has allowed businesses to approach the clearance of a merger from an antitrust point of view with a great feeling of confidence and a feeling that they are going to have an op-

portunity to review all of their options as they go through that process with the relevant enforcement agency.

Much of that has depended upon the confidentiality that was written into the Hart-Scott-Rodino Antitrust Improvements Act. That Act was well-drawn in that regard, I would say, and I would also very much congratulate the FTC and DOJ staff who have carried out the process since the time the Act came into effect.

They have observed their confidentiality obligations very carefully and as a result business feels very confident in putting filings which include a great deal of highly confidential competitive information. I think if State Attorneys General had ready access to that material, which I hasten to point out is not available to other interested parties like competitors, customers and the like, it would gravely impair the integrity of the process, gravely erode the confidence of the business community in it, and while there is, as I understand it, some attempt in the bill to provide some measure of confidential treatment on the part of the State Attorneys General, it does not seem to us that that is sufficient to assure that that information would be used properly and used only in the context of considering antitrust enforcement. Obviously, information of that kind could be used at the State government level for many other purposes, so I think we have great concern about that.

Senator METZENBAUM. One of the things that has occurred in our economy in recent years, particularly with respect to hostile takeovers, although in some friendly takeovers, the enforcement agencies just have not had adequate time to make an evaluation of the antitrust implications of the takeover and as a consequence of being forced, constrained to act within a 20-day period, realistically have not been able to do the job that they should be doing.

My bill provides for an extension of that time to 60 days, which I might say the FTC supports, with the understanding that that time can be foreshortened by the Department of Justice or the FTC if they are inclined to do so. And I am talking now not about the smaller mergers, I am talking about the mega mergers, the very largest ones.

Would the Business Roundtable have any trouble in giving the Department of Justice or the FTC additional time?

Mr. ONG. We feel, as I understand it, your bill has, as I think you indicated, a double measurement, providing for going from a 30-day period for some mergers, larger mergers to a 60-day period. We have no problem with the first. That seems to us a reasonable change.

We do feel that a 60-day period is probably somewhat excessive, based on experience. We think that is something that we would like to discuss and we hope we would have a chance to work with you in hearings on this bill specifically, which we are not prepared to do yet.

Senator METZENBAUM. I am particularly inclined to work with you in hearings, but let me say we are very much inclined to work with you and to achieve the same end. I think that we have been successful in doing that in the past with some of the business community with respect to this as well as other legislation. So I would say to you that our door is open and I have a feeling we could achieve a mutually agreeable result on that particular subject.

Mr. ONG. Good.

Senator METZENBAUM. Mr. Gellhorn, are you comfortable?

Mr. GELLHORN. You are now talking about the very narrow, it seems to me, and specific questions on the procedural side of Scott-Hart-Rodino enforcement and I really do not get involved on the daily aspects of it and I do not think I have anything to contribute.

Senator METZENBAUM. Mr. Pitofsky and Mr. Scherer, do you have any trouble with increasing the time in which the FTC and the Department of Justice——

Mr. PITOFSKY. I do not think so. The waiting periods are rather short and produce a perverse result. The government is concerned that it gets all the information it possibly can get in the shortest amount of time, and puts out these massive requests calling for enormous amounts of documents. Then, government lawyers really do not have time to read them. So I would think that some modest increase in the waiting period, not enough to interfere with an efficient market for mergers, makes some sense.

Senator METZENBAUM. Mr. Scherer?

Mr. SCHERER. I am not sure it is a good idea for the enforcement agencies to ask for all these boxes of documents. Usually, one knows enough in advance to ask the right questions, and more documentation usually means worse decisions.

The main implications of the 60 days are in the securities markets, and there are pluses and minuses. The plus is, it would probably slow down a phenomenon that is at least troubling. The minus is that if a company is in play for 60 days or longer, its management's attention is going to be diverted totally for an even longer period from running the ship well to dealing with the takeover threat. I think that is a fairly significant minus.

Senator METZENBAUM. Mr. Gellhorn, may I ask you—or I will ask each of you. Mr. Scherer, are you testifying on behalf of anyone other than yourself today?

Mr. SCHERER. No, sir, I am not.

Senator METZENBAUM. Professor Pitofsky?

Mr. PITOFSKY. No.

Senator METZENBAUM. Mr. Gellhorn?

Mr. GELLHORN. No, sir.

Senator METZENBAUM. Mr. Ong, we know you are testifying on behalf of the Business Roundtable.

I think we could carry on but I do not have any further questions at this point. I will say that the Chair of this committee would like to move this legislation, and as I interpreted your remarks, the general consensus that I felt was very strong opposition to the Attorneys General having access to the filings but some support or considerable support, maybe total support for closing the loophole and a willingness to negotiate some of the details of the other provisions of the bill.

Now, if I have misstated anybody's position, please feel free to speak up, but I understood that to be the general position of you.

Mr. PITOFSKY. I did not realize the Attorney General access issue was going to be debated as much as it has been today. I have a slightly different view. I think it is important to understand why it is that we have so many private challenges to mergers and why we have so many actions on the part of State AGs in recent years.

I too believe that merger enforcement is best handled at the Federal level, but during a period in which merger enforcement is so lax it is only natural to have other people who want to become participants in the game. This is a government of checks and balances. Mr. Gellhorn mentioned the *Cargill* case. The *Cargill* case result in the district court, allowing a competitor to sue, occurred in part because the Department of Justice told the Court that it was not going to act and that there was a private party that was in the wings.

Many of these State AGs, frustrated at the level of merger enforcement, are becoming more active. Facilitating their ability to make sound decisions is a public benefit, and therefore access to these materials makes sense.

Senator METZENBAUM. Mr. Scherer?

Mr. SCHERER. Yes, I have a fairly strong view about that too. I disagree with Mr. Gellhorn that the issues, for example, in the great petroleum merger cases were at an international level. Rather, the State Attorneys General were concerned with effects on competition at the retail and wholesale level in their particular State markets, and that certainly is a legitimate province of the State Attorneys General, especially when the Federal Government as antitrust enforcer defaults, as it did in the case of the Mobil-Marathon merger and the Texaco-Getty merger.

Senator METZENBAUM. Anybody else? Did you wish to say something, Mr. Ong?

Mr. ONG. Yes, Mr. Chairman. I would just like to reiterate that while I have tried to answer your questions about the specific provisions of the bill succinctly as respects the Roundtable's reaction to them, we are talking about an important and to some degree technical piece of legislation and we would certainly want an opportunity to explore those aspects of it with the subcommittee as it proceeds legislatively. I just want to make that point clear.

Senator METZENBAUM. I understood that and I did not mean to suggest that anybody was saying we are fully signed on but saying that we have very strong objections from Mr. Gellhorn and Mr. Ong to the Attorney Generals having access, and considerable support from Professors Pitofsky and Scherer, but with respect the other four items in the bill, some acceptance as is in connection with one and some willingness to negotiate with respect to the others, and that is all. I just wanted to try to summarize and I do not think I am misstating any position. We look forward to working with you on the subject.

The Chair does have his own timetable and that is yesterday as far as moving, so please be in touch with us. We would like to go forward as promptly as possible.

Senator Heflin, do you have any questions?

Senator HEFLIN. I apologize for being late. As usual, a Senator has demands to be everywhere at all times and it interferes with being here. I have not had an opportunity to read it, so I will not ask any questions now. I will try to review all the written testimony and possibly file some questions later.

Senator METZENBAUM. Well, I want to thank the witnesses for their participation.

That concludes the hearing this morning. Thank you.

[Whereupon, at 11:45 a.m., the subcommittee recessed, to reconvene subject to call of the Chair.]

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